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Brokerage Accounts

A Treatise on the Business of Brokerage
Its Accounting Books
and Records

By

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TO THE
SCHOOL OF COMMERCE, ACCOUNTS AND FINANCE
OF THE NEW YORK UNIVERSITY
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PREFACE

Wall Street has been discussed from almost every conceivable point of view. Its economic value to our present commercial machinery has supplied the basis for many financial articles. Its functions have been made the subject of discourse and legislation.

An article written by Professor S. S. Huebner of the University of Pennsylvania, emphasizes the relation of the Stock Exchange to capital seeking a market.* He speaks of that institution as the "political and financial nerve center of nations and the barometer of national prosperity and adversity"; further stating that the stock market serves a most useful purpose in directing the flow of capital from channels where least needed into those where it can be most beneficially and profitably employed.

In a report by the Hughes' Commission, appointed in 1908 to investigate exchanges, the New York Stock Exchange is commented upon as follows: "The volume of transactions indicates that the Exchange is today probably the most important financial institution in the world. In the past decade the average annual sales of shares have been 196,500,000, at prices involving an annual turnover of nearly \$15,500,000,000; bond transactions averaged about \$800,000,000."

Notwithstanding the commanding position of the Stock Exchange in the world of business and commerce, and the careful consideration it has received from almost every angle, one most important factor has been sadly overlooked—one upon which rests the entire mechanism of "The Street"—its accounting. When the voluminous transactions of Wall Street are considered, the total absence of literature

**Annals of the American Academy of Political and Social Science*, May, 1910, pages 1-23.

bearing upon the technique of its accounts is a matter of surprise.

From the recording standpoint, Wall Street activities resolve themselves into a study of brokerage accounting, and this must logically first discuss the methods, practices, and accounts of stock brokers.

But Wall Street in its broader sense includes not only the stock market and the clearing house, but embraces also the Cotton Exchange through which approximately 15,000,000 bales of cotton are marketed annually, and the Produce Exchange, which deals in grain, provisions, and cottonseed-oil. These commodity exchanges almost equal in importance the Stock Exchange itself, and their accounting must be treated in any comprehensive consideration of Wall Street accounting.

The subject of brokerage accounting, as intimated, is an almost untrodden field. For this reason its interest to the practitioner should be the greater. The present volume is intended to cover the subject with reasonable completeness and to give at least a fair insight into the very technical operations of "The Street."

The author has been unable to avail himself of the work of others in this field, as beyond a few scattered references, there is an utter absence of literature treating the accounting feature of brokerage as practiced in this country. The demand for such a treatise prompted its preparation, being so written in partial fulfilment of the requirements for the degree of Master of Commercial Science of the New York University. The work is, therefore, of a pioneer nature, and the author hopes that it may contribute its mite to the science of accounting.

FREDERICK SIMSON TODMAN.

New York City,
March 1, 1916.

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Brokerage Accounts

Part I—Stock Brokerage

CHAPTER I

CUSTOMER AND BROKER

Legal Relation of Customer and Broker

Under the law of agency it is clearly pointed out that a broker constitutes himself an agent in executing the orders of his customer to buy or sell securities or commodities. Hence, all rules of agency are applicable here in determining the rights and the duties of the respective parties to the contract. In a decision by Justice Day of the United States Supreme Court,* it was held that the broker is but an agent and therefore bound to follow the directions of his principal or give notice that he declines the agency. It was further held that all dividends on stocks purchased for customers, and the profits or losses on such stocks, belong to the customer, who alone takes the risk of the venture.

In the case of *Markham v. Jaudon* (41 N. Y. 256), it was held in substance that a broker's dealings may sometimes be of such a character as to constitute him an independent contractor and not the appointee of a principal. In the vast majority of cases, however, the transactions arising in the course of business are of such a nature as to constitute the broker an agent.

**Galigher v. Jones*, 129 U. S. 193.

The broker's agency usually carries with it a personal, material interest; that is, he has an interest in the subject matter of the contract by reason of necessary outlays and advances made for the customer while the account is still in force. This material interest extends to the equity which the broker may have on account of commissions, or part payment for stocks purchased and interest accrued. The term most frequently used to characterize dealings in which such interests arise, is "marginal trading."

Duties of the Broker

1. The law of agency imposes upon the broker the exercise of reasonable skill, diligence, and good faith.

2. The law of agency enacted in New York, which became effective as a statute in 1910, strictly prescribes that the broker must submit a statement of purchase or sale upon the execution of an order, stating the description of the securities traded in, the name of the person or firm from whom purchased or to whom sold, and the exact time of execution. The penal law also provides that any broker who refuses this information within one day after a written demand has been made shall be guilty of a misdemeanor, and such infraction shall be punishable by a fine or imprisonment, or both.

3. The broker also contracts, although impliedly, to provide the means with which to make delivery to the purchaser in the event of a "short" sale by a customer.

4. The broker also agrees to carry the "short" account of a customer for a reasonable length of time, thus allowing the latter an opportunity to buy in or "cover" such shortage at a lower price.

5. A very important duty devolves upon the broker to notify his principal before closing an account in the case of inadequacy of margin to protect the customer's holdings.

There are various circumstances which enter into such cases, where the important point of dispute centers about questions of reasonable time, service of notice, past habit of dealing, usual custom, and other factors which preclude the establishment of a fixed rule to govern the enforceability of the broker's duty to notify.

6. Inasmuch as the broker is an agent, he must render an accounting to the customer whenever such a statement is demanded. An action in equity may be instituted against the broker upon failure by him to comply with the customer's demand for a statement. Here, again, the fiduciary nature of the broker's employment is made manifest.

Duties of the Customer

The customer, as well as the broker, has certain duties to perform and rules to adhere to in his transactions with his agent, the broker. These duties are as follows:

1. The customer should keep his account amply margined.

2. The customer must indemnify the broker for all outlays and losses incurred for his account.

3. The customer impliedly agrees to pay the usual commission, and as soon as his order is filled this charge automatically becomes an obligation.

4. The customer impliedly authorizes the broker to pledge any securities purchased for him, for an amount not to exceed the total indebtedness in such customer's account. Formerly this authority was frequently carried so far as to jeopardize the customer's equity. To prevent this malpractice, a law was enacted which strictly forbids the broker from overborrowing on his principal's securities. A violation of this law makes the offender liable for an action in conversion.

Rules of the Stock Exchange

Both the customer and the broker agree to abide by the rules and regulations of the Exchange where the transaction is consummated. The constitution of the New York Stock Exchange is so replete with rules for trading and conduct of its members, that misunderstandings as to the general procedure seldom go to court for decision.

Duration of the Agency

The rights and the duties of the two parties, broker and customer, continue until the purposes of the agency shall have been consummated. They are terminated through the sale of securities held by the broker for the benefit of his principal; or by a transfer of the account and the securities upon payment made by the customer; or upon payment for his benefit by a third party.

In cases where a customer is "short" of the market, the account is technically closed at the time of "cover," or in other words, when a purchase is made against the shortage.

In the case of a "close-out" or involuntary disposition of the principal's holdings—either "long" or "short"—the account is closed and the agency thereby terminated against the customer's wish.

This method of closing an account is in line with the principle of law which gives a person the right to preserve his lien or equity in the subject matter of a contract.

Stop Orders and Margin Calls

The system of "stop loss orders" is resorted to in cases where a customer's margin is near the point of exhaustion; and before his stock is sold, it is always to be presumed that sufficient and reasonable notice has been served upon the customer, declaring the intention of the broker to "close out"

the account. This notice must state the time and the place of disposition. What constitutes reasonable and sufficient notice is determined by the circumstances of the particular case. Generally speaking, the broker should notify his customer that his margin is running low, and request additional margin before the account is closed out.

Where the market is "wild," the customer should be kept informed so that proper provision may be made by him for the protection of his interests. In a normal market, however, more formal notice should be sent, when the conditions are such as to require the customer's attention. But it must again be emphasized that it is incumbent upon the broker to give notice before any steps are taken by him to make disposition of a customer's securities.

Upon payment made by the customer in answer to the call for additional margin, or when a reduction in the holdings has taken place, the stop loss orders should be cancelled and the account allowed to continue as theretofore.

Representation on the Exchange

All the more important concerns engaged in the trading of securities for the benefit of third parties have representation on the "board" or "floor" of the Stock Exchange in the person of a firm member. All orders for the purchase or sale of securities are sent to him for execution.

Many concerns, however, though actively engaged in the stock and bond business, have no connection with the Stock Exchange. All their orders for the purchase or sale of securities are given to a brokerage firm which has membership in the Exchange, and the latter firm treats the transactions in the same manner as they do other customers' commitments.

These non-membership firms keep accounts with customers in the usual way, but they must also keep accounts

with their brokers who execute their orders on the Exchange. Thus, if a customer desires to purchase 100 shares of Steel at 60, the order is given to the Stock Exchange house, and if executed, will be entered in the following manner: The customer is charged with \$6,012.50 (brokerage \$12.50), and the Stock Exchange concern is credited with a like amount. This entry, as is the case with all other entries, is passed through the usual general journal. If the stock is purchased outright and paid for in cash, the transaction is passed through the ordinary cash book. No technical books of account are necessary.

The question might properly be asked how such brokers find it worth their while to engage in this business. The answer is that a small profit is realized in the difference in interest between what the broker is charged and what he in turn charges his customers. The truth of the matter is that most of the profit from such a business is made in bond transactions not listed on the Exchange. In such bond deals the usual commission of $1/8\%$ is charged by the broker, besides any other perquisite which he may receive in the transaction. To illustrate the latter point, suppose that the broker receives a bid for bonds at 100 minus $1/16$, and that he makes the offer to his client at 100, or 100 plus $1/8$ commission. All such differences make for profit. Persons engaged in this business usually operate on a limited capital, and their profits are not any too large.

There is still another group of Stock Exchange concerns which, while operating on the Exchange, do not settle their own transactions, leaving this matter entirely in the hands of other firms. For this service they are charged a commission of $1/32\%$ on purchases and a like charge for selling. Such brokerage houses do not have occasion to use technical books, as all entries are passed through the journal or the cash book.

CHAPTER II

THE BOOKS OF ACCOUNT

Individuality of Records

Generally speaking, each line of business has its own records peculiar to that business, from which it should be possible to read the history of the enterprise. Also, if these books are systematically arranged, it should be possible to compile from them such financial statements as will enable the executives to determine the present condition and the future administrative policy of the business. Hence, for an accounting system to be efficient it must be one "created to meet the particular needs of the business for which it is intended, and not a general system forced on the business regardless of its individual requirements."*

Influence of State Law and Exchange Rules on Records

Individual needs in the business of brokerage require that the set of books employed to record the transactions be of such construction, ruling, and arrangement as to conform not only to the type of the organization, but to the somewhat dictatorial policy of bookkeeping custom which prevails in "The Street." The very technical pursuit of the business itself presupposes a set of technical books. Also, to some extent, the books are affected by the laws of the state and the rules of the Exchange. Likewise, the by-laws of the Stock Exchange relating to the delivery of securities and the commission laws, prescribe certain books which must contain specified information. To illustrate the extent of Exchange supervision when hearings are in progress, the Board of Governors, or any special committee which that

*"Practical Accounting Methods," Moxey, page 1.

body may designate, may demand and enforce the production of all the private books of account used by any member of the Exchange, under pain of suspension or expulsion.

Uniformity in Brokerage Bookkeeping

Unlike mercantile or manufacturing businesses, in which the books and the method of keeping them are so often the unrestricted selection of the employer or the bookkeeper, and vary in almost every case, brokerage books are, to a certain extent, uniform in all the different brokerage houses. What is more, the method of keeping these books is practically the same in the different houses in spite of the fact that a better grasp of accounting principles may dictate, in some instances, a more sensible and accurate handling of certain items. Even though the books may be elaborated and vary as to detail, the principles underlying the theory and the construction of the accounts remain unchanged and unchallenged.

Behind this supporting theory is to be found the inviolable custom of doing business. Each brokerage house meets practically the same problems as does its neighbor, and the solution and disposition of the problems are universally and well established. There are seldom to be met two conflicting theories to render a problem unworkable.

For purposes of analogy, let us take two banks doing the same kind of business and located in the same vicinity. As the supreme authority, the banking laws are the directive agencies for the conduct of the business. A strict adherence to banking custom, or what may be termed precedent, would very likely be responsible for the establishment of some positive accounting system which would be found in either bank. The introduction of the clearing house brings new needs in connection with the records employed, which are the same for both. As a result of this we find that the system of

accounts obtaining in one bank may be safely expected in the other bank doing a similar business. Thus it happens that the books of account of a business like banking or brokerage, although highly developed and diversified in character, are the creatures of the same necessities, and are therefore in their important features practically the same.

At this juncture let us remember the fundamental principle that books are either journals or ledgers; they either recite facts or summarize them. If we can take the component parts of the antiquated day book and call one section the purchase journal; one, the sales journal; the third, purchase returns; and the fourth, sales returns, etc., the division should not confuse us if we but remember the origin and character of the book. For the same reason the high-sounding and technically named records of the broker should not be confusing. Some of these are statistical in nature and construction, and can scarcely be called financial books of account. Others, of which mention is made later, indicate, if by no other means than their names, the class to which they belong.

Records Used in the Stock Brokerage Business

The books of account and record which are most commonly found in the business of buying and selling securities for customers are as follows:

1. Purchases and Sales Books
2. Blotters
3. Customers Ledger
4. Private Ledger
5. Securities Ledger
6. General Ledger
7. Stocks Borrowed and Loaned Book
8. Money Borrowed and Loaned Book

9. Margin Book
10. Stock Transfer Register
11. Vault List
12. Revenue Tax Register (required by law)

The individual books and records, in the order given above, are analyzed and explained in detail in the several succeeding chapters; the form, ruling, and arrangement of each being shown. A study of form and ruling is important in technical books of account such as these. Half of the question as to whether the record is one of original or secondary entry, is answered by a knowledge of the prescribed construction of the accounting media. Since there has been such a complete departure from the simple column system of books, columnarization also should be closely observed in this study.

CHAPTER III

PURCHASES AND SALES BOOKS

Advantage of a Bound Record

As has been mentioned, the broker is mainly occupied in trading in securities for the benefit of third persons. Therefore, the first book for recording transactions is the "Purchases and Sales Book." This may be either a loose-leaf device or a bound book. While loose-leaf systems are rather prevalent, it appears that, as a book of initial entry, the contents of this record could be best preserved in bound form, thus avoiding the probability of loss or destruction inherent in loose-leaf devices.

Clearing House and Ex-Clearing House Books

By reason of there being an arbitrary classification of stocks into two divisions, i.e., (1) clearing house issues, and (2) ex-clearing house issues, it is found very convenient to employ two purchases and sales records. The ease with which odd lots of stocks and bonds can be segregated from the clearing house listings, makes this division a very simple and expedient one. Thus, the ex-clearing house book will contain odd lots of a clearing house nature, hundred-share items of an ex-clearing house character, and odd lots of the latter class; also bonds of all descriptions. The clearing house book contains, strictly, listings of the Clearing House in quantities of 100 shares or multiples thereof. The two books are similar in construction, the arrangement being such that a complete history of each transaction is given. The transactions of each day are grouped conveniently and chronologically.

From Forms 1 and 2 it will be seen that all essential information concerning purchases and sales is furnished by these records.

Use of the Purchases and Sales Books

The subject matter contained in these forms is almost self-explanatory. But as some question might be raised as to the uses of the "When Received," "When Delivered," and "Time" columns, a word of explanation becomes necessary.

As stated more fully later, all securities are scheduled for delivery upon the next business day, Saturdays excepted. If the seller is unable to deliver within the prescribed time, he has "failed to deliver," and makes up for this deficiency by delivering the securities in question upon the next following day and within the set time.

The "Time" column is used for the purpose of recording the character of the accepted bid or offer as made between the brokers in the transaction.

Under Article XXIII, Sec. 3 of the Constitution of the New York Stock Exchange, bids and offers for the purchase and sale of securities may be made as follows:

(a) "Cash," i.e., for delivery upon the day of contract. As soon as the bid or offer is accepted, the stocks and bonds are delivered to the broker and payment is made upon them.

(b) "Regular way," i.e., for delivery upon the business day following the contract. This is the most common method of dealing, and in absence of any other specifications in connection with the purchase or sale, it is always presumed that "regular way" is intended.

(c) "At three days," i.e., for delivery upon the third day following the contract. It may be that securities may be coming from out of town, or that they are not within the immediate control of the seller for some other reason, or that the buyer will not be in a position to accept the securities

before that time; all of which makes necessary the specified bid or offer.

(d) "Buyers' or sellers' options" for not less than four days nor more than sixty days. On such transactions written contracts are exchanged on the day following the transaction, and carry interest at the legal rate, unless otherwise agreed; on these contracts one day's notice is usually given, at or before 2:15 P.M., before the securities are delivered prior to the maturity of the contract. These bids and offers are usually made where it is impossible to make delivery of or receive the securities involved for at least four days. This method of trading is greatly in vogue among brokers who buy or sell for European account.

On Forms 1 and 2, illustrations of the various methods of buying and selling are given. Invariably all clearing house items are "regular," whereas "odd lots" and bonds represent largely the other bids and offers. Of course, by prearrangement, stocks which belong to the clearing house division and which are coming from abroad, may be made ex-clearing house and subjected to the rules of delivery prescribed for other than "regular" transactions.

Abbreviations are used for the purposes of the purchases and sales book. "C." for cash; "R." for regular way; "S. O.³" or "B. O.³" for seller's or buyer's option at three days; "B. O.⁴" or "S. O.⁴" for buyer's or seller's option at four days. Where more than four days is intended, the exponent indicates the number of days allowed for delivery or receipt of the securities.

By writing in the date of receipt or delivery of the shares or bonds purchased or sold, and the character of the bid or offer, the record is made complete, statistically. Hence, all entries expressed therein are traceable chronologically to the succeeding book or books involved in the transaction, by merely referring to the date of settlement.

This information is mandatory on the part of the broker, and the book in which it appears is one of the many necessary records which he must furnish when called upon to do so by the Exchange.

CHAPTER IV

THE BLOTTERS

Blotter Entries

After the transactions have been recorded in the purchases and sales books, the same trades are written up or entered in either the "Clearing House Blotter" (Form 14) or the "Ex-Clearing House Blotter" (Forms 15, 16), depending altogether upon the classes of securities, whether they be clearing house or ex-clearing house issues. Here, again, this division facilitates entry and classification of securities.

The Blotter as a Financial Record

In the stock brokerage business, both the general journal and the cash book, as they are commonly used, are completely superseded by the blotter, which is really the first book of a financial character. From it are posted to the ledger all purchases and sales and all other entries involving either cash, transfers from one account to another, or adjustments. It is the record which is in use throughout the entire business day. It reveals the cash condition of the firm and determines the extent of borrowing necessary to finance the transactions of the customers. It also measures the lending capacity of a firm which, having too large a surplus of cash, may lend the same out "on call." The auditor will find that the blotter, if well kept, will furnish every detail essential to a thorough examination of the broker's operations.

The Principle of the Blotter

The principle underlying the operation of the blotter,

which makes possible the combination in it of cash book and journal, may be traced to its columnarization. This is so arranged and regulated by usage that the appearance of an entry in one column or another, will indicate immediately whether cash has been exchanged in the transaction or whether it is intended merely to effect a transfer from one account to another.

When the broker advances cash for the payment of his customers' purchases, or when cash is received against the sales of securities, elements of commission and transfer tax enter into the transaction. When stocks are "returned" or "called," an interest item is to be considered; when money loans are liquidated, the same factor of interest must be reflected in the blotter. Throughout, it will be observed that the special ruling of the blotter classifies and characterizes its entries.

Before taking up the discussion of blotter columnarization, another salient feature which distinguishes the blotter should be commented upon. Instead of the debit and credit journal columns adjoining each other (as in the two-column journal), or appearing upon the same page, here the debit entries affecting the accounts appear on the "To Receive" page and the credit items are removed to the adjoining or "To Deliver" page.

Cash Entries

Under the general principles of the cash book, the receipt of cash is reflected on the left side of the book, and the corresponding credit is given to the account yielding the benefit. In the case of the blotter, the receipt of cash is shown on the deliver page. Again, the disbursement of cash, appearing upon the right side of the cash book, is reflected on the receive side of the blotter. The idea of the purchase and consequent charge to the customer, or the sale and credit to the

customer, is paramount, while the cash receipts or disbursements are considered only as incidental for the reason that all transactions are of a money or financial nature; and it is presupposed that cash will be either received or paid as the circumstances require. To further clarify this apparent inconsistency, it may be said that custom has established the rule in the Street that all purchases and settlements therefor be shown on the receive page of the blotter; the debit in this case meaning a debit to the customer and a credit to cash. On the other hand, all sales and the subsequent receipt of cash are reflected on the deliver page, and the credit so appearing is a credit to the customer and a charge against cash.

While it requires constant watchfulness on the part of the bookkeeper to post debit and credit items correctly from the ordinary cash book, and while he must keep the principle constantly before him that an item on the disbursement page is to be read: "Debit account; credit cash," the arrangement of the blotter, on the other hand, is such that when an item appears on the right-hand page it means at once a credit to the account. Thus no mental process becomes necessary to assist in posting the entry correctly.

Since the blotters serve as cash books, it is necessary for the cashier to adopt some means whereby the cash balances at the close of a given day can be carried forward to the succeeding day's blotter. As the chain of entries would be disturbed by this, the cashier will, at the close of each day's business, balance the blotters and carry forward to the succeeding day's records the balance which appeared at the close of the previous day, as shown on Form 16. By this method each day's transactions are complete by themselves, and only for the purposes of correction are the entries appearing for previous days referred to again. The balancing of the blotters is treated more in detail in Chapter X.

The Blotter as a Barometer of Finance

From what has been said in the preceding paragraph, it is apparent that the balance of cash for any particular day can be found by deducting the amount appearing on the receive page from that which appears on the deliver page. The cashier therefore looks to the blotter for the condition of his balance. This is the barometer of his finances, from which he reads the amount necessary for immediate purposes, or what amount he can lend on call. The importance of this is quite apparent. At the close of the daily business the cashier takes into consideration the value of the purchases to be provided for on the following day and the proceeds which the sales of securities will net. Taking into account the present bank balance or balances, adding the proceeds from sales, and deducting the cost of purchases to be financed, a cash condition is arrived at which determines immediately the extent of borrowing or lending. Besides, it determines the means of procuring needed funds, or shows the extent to which excess funds may be loaned.

Alternating Blotters

Where the single blotter system is in operation and the volume of business is large, the bookkeepers find difficulty in getting an opportunity to post the daily transactions. This is due to the fact that under such conditions the blotter is balanced at a very late hour, and that as soon as it is balanced, the blotter clerk begins to enter the purchases and sales, charges and credits, for the ensuing day. This he does because it is absolutely necessary that these records be kept up to the mark. An unusual delay will almost invariably result in a loss to the broker.

In order to obviate the disadvantages attaching to the single blotter system, many concerns in the Street have adopted the system of alternating day blotters. Under this

method two clearing house and two ex-clearing house blotters are employed, and are operated in such a manner that the transactions of the preceding day are conveniently posted without interruption to either the cashier's department or the blotter clerk. To this end the clearing house transactions occurring on Monday and Wednesday are entered in the blotter known as the "Tuesday and Thursday C. H. Blotter." All clearing house listings which have been dealt in on Tuesday, Thursday, Friday, and Saturday are entered in the "Monday, Wednesday, and Friday C. H. Blotter."

All ex-clearing house items are treated in the same way, giving rise to the need of a "Monday, Wednesday, and Friday Ex-Blotter," and another in which to write up the purchases and sales settled on Tuesday and Thursday. The ex-blotter of Tuesday and Thursday carries with it the petty cash entries which are frequently "put through" (posted) on Saturday. In order, therefore, that the name of this book shall cover its purpose fully, it is usually called the "Tuesday, Thursday, and Saturday Ex-Blotter."

Any cash disbursements other than for the payment against purchases, or cash receipts other than for the sale of securities, find expression in the ex-clearing house blotter in use the day on which the receipt or disbursement is made. The same holds true of adjustment entries. Thus, the Monday, Wednesday, and Friday ex-blotter might contain an odd-lot purchase made on Saturday, and under the same date there might appear an entry attesting to the receipt of \$500 as margin from John Jones. In other words, cash disbursements and cash receipts are posted to the various accounts concerned upon the day that such cash exchanges are made.

Ruling and Arrangement of the Blotter

The blotter may be in the form of a loose-leaf device, or it may be a bound book. The latter is preferable for the

reason that, being both cash book and journal, its records are permanent and important—too important to be exposed to the destruction or loss so easy under the loose-leaf systems.

It will be seen, by referring to Form 3, that for the most part the descriptive captions of the blotter columns are identical with the headings found in the purchases and sales book. Thus the history of any transaction is doubly given, but in the blotter it is expressed in financial form; that is, the values as well as the quantities of shares in a transaction are given.

Distinction between the Blotters

The clearing house and ex-clearing house blotters are identical as to form. They differ, however, in the uses to which they are put and in the method of balancing. Thus the ex-clearing house blotter serves for the recording of all the issues of stocks and bonds entered in the ex-clearing house purchases and sales book, as stated in Chapter III. Also it performs the additional function of a journal in the matter of adjustments, and as a cash book in reflecting the cash receipts and disbursements of the business. Its functions reach as far as controlling the clearing house items after they have passed through the usual channel of clearance with the New York Stock Exchange Clearing House. As can be judged, then, the clearing house blotter serves only for the entering of such issues as come directly under the jurisdiction of the Clearing House, leaving the matter of cash exchanges therefor to the ex-clearing house records, depending altogether upon which day's book is being used.

In contents as well as in use do these blotters differ. Taking as a simple illustration, the "Interest" columns in the respective blotters, it will be found that the interest appearing in the clearing house blotter will represent interest on clearing house stocks only. This interest will arise from

“returned” or “called” stocks. The “Interest” column of the ex-blotter will represent, invariably, the interest which is paid or received from money loaned or money borrowed transactions. With the clearing house blotter the main concern is the return or call of stocks used for delivery purposes only. As explained in Chapter VI, lending or borrowing stocks involves the use of money upon which interest is calculated. In the matter of the ex-clearing house record the interest arises without regard to stocks, their return, or call.

CHAPTER V

THE LEDGERS

Classification of Ledgers

The ledgers used in the stock brokerage business may, for the purpose of division, be classified as follows:

1. Customers Ledger
2. Private Ledger
3. Securities Ledger
4. General Ledger

A majority of the brokerage houses combine the first and second of these ledgers into the general ledger. However, as this is not always done, the form and ruling of each ledger is here considered separately.

1. The Customers Ledger

On the debit side of the customers ledger, which is usually a loose-leaf device, the following columnar arrangement is the one commonly employed: "Date," "Explanation," "Price," and "Amount" (to be charged). In case of a purchase, the commission of $\frac{1}{8}$ of 1% is not entered to be added to the purchase price, but is included as part of the total cost of the purchase, i.e., the amount to be charged. Thus, in the purchase of 100 shares of United States Steel common at 54, the cost will appear as \$5,412.50 and not \$5,400 as might be expected. In other words, the commission charge is included in the cost of the shares, and the total placed in the "Amount" column. Besides purchases, the interest charges, computed monthly, and the

record of the "net longs" are reflected on the debit side of the customer's account. Long securities represent either securities held during a period as margin against other purchases, or as margin against short sales and net purchases of the same security.

On the credit side of the account will appear the sale of stocks and bonds; the delivery of securities to a customer, or for the account of the customer against liquidated balances; also payments in cash on account of margin. "Net short" securities of a similar class will be brought down after balancing the account. By the expression "short" is meant the selling of shares, not previously purchased or held, but sold with the expectation of realizing a profit through the decline in value of such shares. The subsequent purchase of shorts is known as "short covering" or "cover."

Hedged Accounts

An account may be long and short at the same time. As an illustration, a customer may be long of Union Pacific and short of United States Steel. Such an account is said to be "hedged." This expression means a mixed account, containing items reflecting contradictions or opposite tendencies.

The term "hedged" also means a condition of an account in which the prominent feature is the sale of a different security from the one "long," or the purchase of a different security from the one "short." The true purpose behind such trading is to check losses caused by a declining market when long, or by an advance in prices when short of the market.

The status of some accounts which will be found spread upon the customers ledger, no matter which system is adopted, will be quite alarming when the point is reached of preparing the balance sheet, compiling the "Table of Equities" (Form 24), or computing monthly interest charges on

the customers' accounts. Taking a hypothetical case, let it be assumed that John Wilson purchases 100 shares of Steel at 56; that upon this purchase he deposits the sum of \$1,000 as margin (equivalent to ten points). His debit balance then is \$4,612.50, against which he retains an equity or margin in his holdings. In technical parlance, this is a long account. The market declines, and in order to check further loss he elects to sell 100 shares of Union Pacific at 157. After deducting the usual charge for commission and tax, the proceeds from the sale of the Union Pacific are \$15,685.50. By reason of this sale, Wilson receives a credit, and the account at this point is "hedged." Wilson's account will then have a credit balance of \$11,073. This, of course, is a fictitious credit, and this status of the account is explained by the statement that such a credit exists subject to certain short coverings or disposal of longs.

Wilson has a margin on the Steel stock. If he should either deliver the Union Pacific to his broker, or cover this stock, his account would again become one of like tendencies—a simple account technically known as a "long" account. Or if the Steel stock should be sold, the account would still retain the simple form under the technical name of a "short" account. In the latter case Wilson would retain an equity in his short Union Pacific to the extent of the balance of \$1,000 deposited as margin, less any loss or interest charges which he might have suffered on his Steel stock.

This mixed account difficulty may be overcome by setting up separate "short" accounts for the purpose of segregating short sales of the customers, who at the same time are perhaps long of other securities as shown by other accounts called "long" accounts. This practice is the correct one, although it will be found that the one first described is the more common.

Objections to the Hedged Account

Here the fictitious and misleading results of the mixed or hedged account should be pointed out. Besides the difficulty in reading hedged accounts, another objectionable feature is the complexity encountered in the computation of interest. As an illustration of this, take the account of Richard Ross. On September 1, his account shows a credit balance of \$11,073, with 100 shares of Union Pacific short and 100 shares of Steel long. The purchase price of the Steel is perhaps lost sight of, as well as the sales price of the Union Pacific, if the transactions are of long standing. On what balance is interest to be computed, since Ross' account shows a false credit?

If Ross' account were analyzed, and the purchase cost of Steel and the proceeds from the short sale of Union Pacific were again established, it would appear, in effect, that the broker had advanced money on the Steel purchase but had received no benefit from the sale of Union Pacific except his commission. Therefore, the account of Richard Ross should be charged with such interest as will recompense the broker for his outlay. But, how difficult is this operation, as compared with the ease of interest calculations when the long Steel, upon which interest is chargeable, appears in one account and the short Union Pacific, upon which no interest is allowed, appears in another account?

Customers Ledger Not Subsidiary to General Ledger

It has probably been assumed that the customers ledger is operated as a subsidiary to the general ledger, and that somewhere in the latter appears the controlling accounts for customers and creditors. This is not the case, however. While the customers ledger (if employed) is in a sense subsidiary, it is not operated under that principle. The columnarization of the blotters from which entries are posted

to the customers ledger, is such that no customers' or creditors' controlling accounts in the general ledger are possible. So, to all intents and purposes the customers ledger is in itself a part of the general ledger, and nothing more than a device to make the general ledger less unwieldy, and to make posting less difficult by distributing the bookkeeping operations. The balance totals of the customers ledger must find expression on the trial balance sheet before the latter can be complete and in balance.

Definition of "Customers"

The term "customers," as employed in the Street, much opposed to the usual interpretation, means a trader—a purchaser or seller of securities for either investment or speculation. A customer's account may show a debit balance, together with securities long. The value of the securities at the market price should usually exceed the amount of the debit balance. Thus, to the extent of his margin the customer is a creditor. On the other hand, the account may show a credit balance with securities short. Here, again, the "cover" value of the securities should be considered in order to determine the true status of the account. Generally speaking, it is very difficult to class the customer as debtor or creditor, for he may be either in the broad sense of the term.

2. The Private Ledger

It is often advisable to keep from the minor clerks who have access to the books, a knowledge of the income of the concern, the capital accounts of the proprietors, and other vital business accounts. When this is so, the "Private Ledger" is adopted.

If a private ledger is kept, the balances contained in it, or their totals, must appear in the trial balance.

Notwithstanding the advantages of the private ledger, the matters belonging to it are often incorporated in the general ledger; this in response to the present decided tendency toward concentration of the records wherever possible. As in the case of the customers ledger, the private ledger is merely a part of the general ledger, separated from it for reasons of expediency, and the principle of control cannot be operated.

3. The Securities Ledger

The securities or stock ledger, as the record is interchangeably called, differs in both use and form from the ordinary stock ledger which is employed in mercantile and corporate enterprises. This particular record is not intended as one for summary purposes, nor is it a financial book. It is used only for listing securities and to show their places of deposit, or other disposition.

Many forms of this ledger are in use, but its one underlying purpose remains the same, despite the numerous elaborations. Its most common form is the loose-leaf device, as that is best adapted to the increasing or decreasing volume of securities recorded. The security holdings are of such a diversified nature that one sheet or more, as the case demands, is allotted to each kind of stocks or bonds.

As far as it is possible, the sheets containing the individual listings of a certain issue of securities should be arranged alphabetically. The advantages thus gained are self-evident.

The longs on the left side of the ledger represent customers' holdings or stocks borrowed from brokers in the Street. On the right-hand side is a record of short securities, representing customers' short sales, together with a list of stocks which might be "loaned" out in the Street or which might be acting as collateral in bank loans.

Stock Loans

Here it may be well to explain that the distinction between collateral in the case of bank loans, and stock loans in the Street, depends upon the intentions of the lender or the borrower. Is it the intention of the borrower to use the stock so borrowed, and for which money has to be parted with, for the purpose of delivering the shares against short sales of his customer? Or is it his intention to lend money and hold the stock as collateral for the loan? These are the questions to be answered in determining the intention of the transaction. If the first question is answered affirmatively, then a true illustration of the stock loan is furnished. If the second question is so answered, then an illustration of the ordinary collateral loan is presented. Banks are in the habit of making collateral loans. Brokers, on the other hand, frequently borrow securities, but only as they are necessary for the purposes of effecting delivery against short sales. The borrowing and lending of stocks is more fully discussed in Chapter VI.

The Ruling of the Securities Ledger

The page of this ledger is divided in the center by a vertical line, as shown in Form 4. At the top of the leaf is inserted the name of the security recorded. The left side of the page is further subdivided into six columns, which are headed from left to right with the descriptive captions, "Date," "Number of Shares," "Certificate Number," "By Whom Owned," "For Whose Account Borrowed," and "From Whom Borrowed." On the right half of this page are six columns headed, "Date," "Number of Shares," "Certificate Number," "For Whose Account Short," "To Whom Loaned," and "Place of Deposit."

This record is one of the books of the cashier's department or of the stock clerk. To a great extent it operates

as a check upon all securities which pass in the course of the day.

Method of Keeping the Securities Ledger

At any given time it should be possible to balance the securities by adding the number of shares of stock or bonds represented on the left side of the sheet, and comparing this with the number entered on the right side. These footings should agree. As an illustration, if Fred Smith is long 100 shares of Amalgamated Copper, the date of receipt will appear in the securities ledger with the number of shares, the description of the stock—Amalgamated Copper—and the name of Fred Smith as owner. (See Form 4.) If the stock has been paid for and delivered to the customer, the record would thereby be cancelled; but if not delivered, the right-hand side of the sheet should reveal the present place of deposit. It will show that the stock has been loaned in the Street, or that it is serving as collateral in some bank loan; or else it might appear as being in the transfer office of the corporation awaiting re-registration, or in the vault of the broker. In any case, excepting the delivery to Smith, the shares of Amalgamated Copper on either side of the record should balance.

Auditing the Securities Ledger

An auditor in checking the securities ledger should demand positive proof that the stock represented in the various customers' accounts tallies with the book under inspection. Further, he should investigate and determine beyond doubt that the stocks as reflected therein are in actual existence in one of the four places mentioned. It is his duty to determine this.

The securities ledger is not a permanent record. At best it is a temporary memorandum which changes from day to

day with the transactions of the customers or with the change in place of deposit of securities. For instance, if John Jones covers his short Steel, this change is reflected by a total cancellation or erasure of the Steel sheet as far as Jones affects it. Also, stock which is loaned in the Street may find its way into a collateral loan the very next day; stock which is loaned out might be called, or stock which is borrowed might be returned. All this shifting changes the stock record so that only through the medium of "throwing back" or referring to the blotters, can the condition of this ledger be determined for a period which has passed.

4. The General Ledger

The general ledger contains the usual nominal accounts, the asset and liability accounts, and a record of the proprietors' interests. The contents exclude the customers' and the private ledger accounts, when these are contained in the other ledgers.

The bound-book form is preferable for the general ledger if a customers ledger is in operation; otherwise it would be more practical to use a loose-leaf device. This is so for two reasons: First, the accounts of the customers, by reason of their voluminous transactions, must be carried forward so often that the loose sheets afford the only practical means of keeping the respective accounts intact. Second, the loose sheets are desirable because of the frequent change in the clientele of a brokerage concern, making the insertion or the withdrawal of sheets constantly necessary.

The ruling of the general ledger sheet does not differ from the standard ledger ruling, except that the explanatory column is more spacious in order that transactions may be fully recorded.

CHAPTER VI

THE "BORROWED AND LOANED" BOOKS

Lending Stocks

In the course of his transactions the broker frequently requires money to meet stock purchases, and on the other hand, frequently requires stock to make deliveries against short sales. These needs are usually met by loaning or borrowing stock as the case may be.

This borrowing and loaning of stock is something peculiar to the Street. After Exchange hours, the loan crowd assembles on the floor of the Exchange. This group is composed of brokers or their clerks who have stocks to loan, and brokers who seek to borrow stock to make delivery against short sales, or for other purposes.

To illustrate the loan of stock, suppose a broker purchases 1,000 shares of Steel common on margin for a customer. As the customer has only put up 10% or such other marginal amount as the broker may require—or in the case of a credit customer, has put up nothing at all—the responsibility of financing the transaction falls mainly upon the broker. Under the rules of the Street the purchased stock will be delivered the next day. In the case of the Steel common, as it is a clearing house stock, delivery will be made by the broker designated by the Clearing Association. If it were not a clearing house stock, delivery would be made by the broker from whom it was purchased. In either case the purchasing broker must be prepared to give his check to the delivering broker the same day the delivery is made, i.e., the business day following the making of the contract.

If the broker has available funds, the question of paying for his stock is merely a matter of drawing his check. If, however, his own funds are not available, he has two courses open to him: First, he can borrow the money from the bank on collateral. Second, he can borrow the money on the Street from one in need of the shares.

It is usually more expedient to borrow money by lending stocks to the Street than it is to employ the bank for that purpose through the means of a collateral loan. In the first case full market value is received; in the latter from 60 to 80% of the value is obtained, not to mention the ease of lending stocks to the Street, and the inconvenience of borrowing from the bank.

If it be a clearing house issue, then all the lending broker does is to exchange tickets with the borrower of the stock, and the transaction assumes the aspect of a sale and purchase, and the Clearing House merely offsets the purchase of the Steel in this case, against the loan of the Steel. The amount involved in the transaction almost approximates the cost price of the shares, so that the lender of the stock pays or receives the difference between such cost price and the clearing house price*—an arbitrary figure established each night by the Clearing House to settle transactions of which lending and borrowing stocks are typical.

However, if the stock to be loaned is ex-clearing house, the matter is a little more difficult to arrange. Then the loaning broker—who is the purchasing broker in the case of the 1,000 shares cited—either makes his arrangements to deliver the shares loaned upon the following business day, or he endeavors to lend the stock before 2:15 P. M. on the delivery day. If he cannot do either, he must arrange to borrow the money through the medium of a collateral loan.

*See Chapter IX.

A question might arise as to how the broker is able to receive the purchased securities in the last cited instance and deposit the same as collateral in order to raise the funds to pay the seller or the broker delivering such stocks or bonds. The broker delivering does not wait for payment from the receiving broker longer than the time necessary in which to draw the check. How then is this question to be answered? Through an arrangement with the bank with which the broker does business he is able to have his checks honored, or what is equivalent to being over-certified; such over-certification or overdraft to be made good by the broker with the funds received from pledging his securities or lending them to the Street.

At this point the broker has bought his stock but has deposited it as collateral for the money with which it was purchased. He may call for his stock at any time, but must, of course, pay back the money borrowed on its security with interest. On the other hand, the broker or bank which loaned the money, may in turn call for its repayment, with accrued interest, and when paid the collateral is returned. In case of a call for the money, the broker on the opposite side of the transaction can usually relend his stock or pledge it as collateral in a bank loan, and thus, as far as he is concerned, leave the whole matter in *statu quo*.

The matter is usually kept in this shape until the customer orders the stock sold. Then the broker makes the sale, and demands the return of the shares loaned, upon payment of the amount borrowed thereon and interest. The stock so redeemed is delivered to the purchaser and the transaction is complete as between the brokers.

Borrowing Stocks

Another transaction usually handled through the loan crowd is the short sale. The customer instructs his broker

to sell short, which, were it not for the rules of the Stock Exchange, would be nothing more or less than a sale at the market price for future delivery. The Stock Exchange, however, requires that when a sale is made, delivery of the stock sold shall be made not later than the following day. To meet this requirement—while still making the profit or loss resulting from the “short” transaction—the customer puts up a margin to protect the broker, and the broker then makes an actual sale at the market, borrowing stock and delivering it to the purchaser the following day against payment of the purchase price. The borrowed stock stands in this condition until the customer orders his short sale covered. This means that the stock borrowed and sold on his account is to be returned. The broker then buys the stock in at the market and returns it to the party from whom it was borrowed. If the price of stock has declined meanwhile, the customer reaps the profit between the price at which the stock was sold and the price at the time the sale is covered, less the broker’s charges. If the price of the stock has advanced, he loses the difference between the price at which he sold and the price at the time of covering, plus the broker’s charges.

The Advantages of Borrowing and Lending

To repeat, lending stocks on the Street, which is equivalent to borrowing money on collateral, is a very advantageous arrangement for the broker who wishes money, inasmuch as he then borrows to the full market value, whereas if he pledged the same securities as collateral at his bank, he would receive but from 60 to 80% of their value. Further, the rate of interest on money loaned on stocks on the Street is usually lower than the rate required by banks for the use of demand money.

The rate of interest charged for money advanced on

borrowed securities approximates the rate charged in the call money market, but is really measured by the demand for and supply of the particular stock. Thus the broker seeking to borrow specified stocks for the purpose of making delivery against a short sale of his customer, must primarily consider the necessity of procuring the shares. Hence, he is not in a position to bargain too closely as to the rate of interest nor to object to advancing the full value in money, because he must have the stock. This is advantageous for the broker lending stocks, and particularly so when the market is oversold, because he can then charge a premium on the stocks loaned. Thus a year or so ago when the New York, New Haven & Hartford shares developed such a short interest in the market, those who held the floating supply were in a position to charge a premium ranging from $1/64$ to $1/16\%$ per day to borrowers of this stock.

Mark-Down and Mark-Up

The "mark-down" (market down) and the "mark-up" (market up) are transactions which are frequently made in connection with stocks borrowed or stocks loaned. It is the custom among brokers to keep all stock loans at the market price; that is, the money advanced or received for stocks borrowed or loaned must be kept at the market value of the stock. For example, suppose that Jones & Co. borrowed from Smith & Co. 100 shares of Steel at 60, and that subsequently the value of these shares declined 10 points. In such a case, Jones & Co. would request Smith & Co. to send the former firm a check for \$1,000 and also interest on the loan from the time of borrowing until adjusted to the market value. This transaction is called a "mark-down," and a new entry under this date is made in the stocks borrowed and loaned book of Jones & Co., thereby constituting a new transaction. The converse of this opera-

tion is known as a "mark-up," and would take place if the price of Steel increased, say to 75, instead of declining to 50. This time, however, Smith & Co. would issue the "mark-up" and request a check from Jones & Co. for \$1,500.

Stocks Borrowed and Loaned Book—Its Ruling and Arrangement

The stocks borrowed and loaned book is an underlying record supporting the ledger accounts "Stocks Borrowed" and "Stocks Loaned."

The book is usually a bound one. It is divided into two sections, the one devoted to the record of borrowing transactions (Form 5a), and the other to lending transactions (Form 5b). The column headings from left to right of the "Borrowed" section are as follows: "Date," "From Whom Borrowed," "Number of Shares," "Description," "Price" (at which borrowed, usually the market or clearing house price), and "Date of Return." Then follow columns for the days of the calendar month, in which appear the interest rates from day to day on the stocks borrowed. The interest rate is either renewed, increased, or decreased daily, depending altogether upon the prevalent rates at which stocks are lending or renewing.

The "Loaned" section of this record is identical in arrangement with the "Borrowed" section, with the one exception that the second column is headed "To Whom Loaned."

Checking the Record

As a check upon the stocks borrowed and loaned book, recourse may be had to the securities ledger already described. The money values involved in the stocks borrowed and stocks loaned should be reconcilable with the general

ledger accounts bearing the captions "Stocks Borrowed," "Stocks Loaned."

Money Borrowed and Loaned Book—a Record of Collateral

It has been observed that the stocks borrowed and loaned book is intimately related to the financing of transactions through the lending or borrowing of securities in the Street. As has been illustrated, a broker can also obtain funds by means of the ordinary bank loan, giving securities as collateral: He can also lend his excess funds upon call or demand, taking securities as collateral for the loan.

Borrowing money from the bank or from any other source upon collateral securities, or loaning money upon call, gives rise to the need for another record which will give expression to such transactions. The "Money Borrowed and Loaned Book" (Forms 6a and 6b) fulfils this purpose. The book is similar in arrangement to the stocks borrowed and loaned book, which has just been explained. It shows the date of the borrowing or lending, the amount involved in the transaction, from whom borrowed or to whom loaned, a list of the collateral given for the loan, the rate of interest, date paid, and provides by means of a special column for the record of any other stock substituted for that originally pledged. As such loans are usually call loans upon which the rates of interest fluctuate from day to day, provision must be made for a reflection of such rate changes. A glance at Forms 6a and 6b will show how this is done, the arrangement adopted being the same as that used in the stocks borrowed and loaned book.

Collateral Substitutions

The use of the "Substitution" column of the money borrowed and loaned book is illustrated by the following transaction:

Assume that the brokerage house of Smith & Co. pledges 500 shares of Steel common (market price 54) and 500 shares of Amalgamated Copper (market price 70) to secure a loan of \$50,000; and that the 500 Steel shares so pledged really belong to a customer of Smith & Co. The customer later sells his 500 shares of Steel common, and Smith & Co. must then deliver the 500 Steel to the purchaser. In such a case they will seek to substitute other securities, the value of which approximates \$27,000, as collateral, in order that the Steel may be released for delivery against the sale. The lender is usually willing to accept stock of approximate value and rating, in place of the securities which the borrower seeks to withdraw, and Smith & Co. having purchased 300 shares of Baltimore & Ohio common, valued at about \$28,000, will be enabled to effect a substitution of stock by depositing the Baltimore & Ohio shares in lieu of the Steel. In the event of a substitution, the stock withdrawn is checked on the money borrowed and loaned book to indicate such withdrawal, and the substituted shares are entered in the "Substitution" column.

Payment of Loan and Return of Securities

In the case of payment of a money loan, the date of liquidation is written across the face of the page, thus attesting to the fact that the loan has been cancelled and the released securities returned.

Relation of Money Borrowed and Loaned Book to Other Books

At this point reference should again be made to the securities ledger (Form 4) to trace the connection between it and the money borrowed and loaned book. In speaking of that ledger, it will be recalled that the position or place of deposit of the securities was emphasized. Consequently, the

securities appearing in the "Money Borrowed" section of Form 6 are traceable to the securities ledger. When substitutions are made, the fact will also be borne out by this ledger. Taking the hypothetical case given above, the Baltimore & Ohio shares would probably have been taken from the safe deposit vault and substituted in the bank loan; while the Steel shares, constituting part of the original collateral in the loan and which were subsequently withdrawn, would be erased from the securities ledger, and the blotter recording the sale and a record of their delivery to the purchaser would vouch for their final disposition.

However, taking the "Money Loaned" section of the money borrowed and loaned book, the securities appearing therein as collateral do not find expression in the securities ledger, for, while they are in the pledgee's hands, in no way is it intended that either their position or ownership shall be recorded among the securities owned. The stocks or bonds acting as security for a loan are the property of the pledger, subject, of course, to the rights and equities of the pledgee.

The accounts in the general ledger, under the captions of "Money Borrowed" and "Money Loaned," exercise a check on the money values representative of the borrowing or lending operations.

CHAPTER VII

CUSTOMERS STOCK MARGIN RECORD

Trading on Margin

Stock trading is for the most part done on margin; i.e., the customer deposits with his broker a part of the purchase cost. To gain a clearer idea of the margin system, this marginal deposit may be regarded as an instalment on the stock, or as a payment on account of an option. The system of margins allows the trader to carry a large line of securities on a comparatively moderate cash capital, with the result that his returns are much greater than they could be if he were required to pay the whole purchase price. To illustrate, if he deposits a ten-point margin on a stock selling at par, he can carry ten times as much stock as he could if he had to pay the full purchase price, and his profits or losses are correspondingly increased.

The Margin Record

The "Customers Stock Margin Record" is probably the most carefully watched of all the broker's books. It should show at all times the status of the customer's account, whether it be long, short, or hedged. If stocks fall, it shows when and to what extent more margin must be called. Or if a customer is operating on a credit extension allowed him by the broker, it shows just how far this has gone, and how nearly the customer has reached his limit. If the margin book is not closely watched, the neglect may cause the broker heavy personal loss.

The record of margins in operation may be adequately

kept either by means of a loose-leaf book, or by a card system. Forms 7 and 8 show the usual style of margin card; while Form 9 gives the loose-leaf margin sheet, showing its operation.

The margin record, whether it be the loose-leaf or card system, should be arranged to show at a glance the name of the account; the number of shares, long, short, or hedged; the description of such shares; the net price (including commission); the market price of such stocks; any losses or gains thereon (by comparison of market price and cost price); the margin deposit; and, either in points or percentages, the margin remaining to carry such commitments. It is essential that all these facts be presented, quickly, systematically, and logically.

The loose-leaf margin record, which is the more practical and convenient of the two methods in use, should be so arranged that each section of accounts will be in alphabetical sequence. In a widely fluctuating market the merits of the loose-leaf device will be evident. The card system carries with it the usual liability of the destruction or misplacement of the cards when most needed.

Marginal Requirements

The usual marginal requirements are ten points on the number of shares held. Frequently, a percentage of the cost value will be required, but this depends altogether upon the policy of the broker or the nature of the stock carried—whether highly speculative or otherwise. In the event of a hedged account, the requirements might be less. Thus, a margin of \$1,000, or ten points, would usually be required on an account long 100 shares of Steel or short 100 shares of Union Pacific. A margin of five points would, however, more than cover the requirements of a hedged account long 100 shares of Steel and short 100 shares of Union Pacific.

Operation on Credit Extension

When a customer is operating in the market upon a credit extension allowed him by the broker, the amount of such credit is in no way regulated by contract. The broker usually carries the account up to a point where a considerable sum is owing, or until in his judgment he requires additional funds with which to finance these holdings, when he will make a demand upon the customer for a sufficient sum to adjust the account to market values.

To illustrate, a wealthy client places an order with his broker for 5,000 shares of Steel preferred, which are purchased at 107. On this commitment no margin is required, and it is incumbent upon the broker to finance the transaction. The price of Steel preferred declines to 102. This means a paper loss to the customer of \$25,000. In some way the broker must make up this difference, either by depositing additional collateral if he has borrowed at his bank, or by receiving a mark-down if he has made a stock loan. If he has a sufficient supply of capital, it will not be necessary for him to issue a margin call to his customer. On the other hand, if the broker is short of capital, he will make a margin call, receiving from his client securities whose market value approximates \$25,000 and which could be pledged, or else he will be given a check to cover the difference in values.

Operation on a Cash Margin

All other accounts, including those of the operator, speculator, or small trader, must be carefully watched in order to know when the calling point for additional margin is reached, or to ascertain the standing of the account after added lines have been taken on. In other words, it must be determined if the account is well enough margined to allow an increased interest in the market, either long or short.

To illustrate, let it be assumed that a customer purchases 100 shares of Steel common at 56; that upon this transaction he deposits the usual ten points, or \$1,000. His margin sheet would reflect this purchase. If the market price of Steel remained unchanged, the customer would retain his equity of \$1,000 less commission on the transaction.* Assuming, however, that the price of Steel declines to 51, the account or condition of margin would reflect an equity of only \$500, since the loss at the market price consumed the other portion of the margin deposited. On the other hand, if the value of Steel had risen to 61, the equity or margin would be increased to 15 points or \$1,500.

Throughout the study of margins, it will be found that for the most part it is one of constant watchfulness on the part of the broker. When a decline occurs, the customer must be asked for additional margin in order that the condition of his account may be improved and the margin on his securities be brought up to the proper percentage of the market prices. The vital importance of this matter is illustrated in treating "Equity Tables" in Chapter XIV.

Selling at a price which will prevent loss to the broker or his customer is called a "stop-out." Thus, if the customer overlooks a call for margin, it frequently results in a loss of the entire margin he already has up, and in such case he is sold or "stopped out." This saves the broker, but if he delays the sale too long it may result in a financial loss to him. Thus, if the price of Steel bought on margin at 56, declined to 44, it would be beyond the exhaust point, and not only would all margin be lost, but the broker would himself incur a two-point loss. The account would then be in a condition of minus-equity—a true type of a "doubtful account receivable" of the broker.

*A commission of $1\frac{1}{4}\%$ is immediately added to the cost, making the net cost as reflected by the margin sheet, $56\frac{1}{4}$, this representing the commission both ways—purchase and sale.

CHAPTER VIII

MISCELLANEOUS STOCK RECORDS; ORDER OF ENTRY

Stock Transfer Register

If a dividend on stock should be declared and the transfer books be closed for a certain number of days before payment, as is usually the case, the broker purchasing such stock meanwhile would be prevented from transferring it to his own name or the name of his customer. The one in whose name the stock is registered will then receive the dividend check. Thus the "selling" broker, or holder of record, becomes a collecting agent for the purchasing broker in the matter of the dividend. For this service a collection charge of 1% is frequently made. To escape this charge, and to insure the prompt and proper receipt of dividends or interest, it is considered good policy to transfer stocks or registered bonds into the name of the holder, wherever possible.

The "Stock Transfer Register" (Form 10) serves to record all stocks in the process of transfer. It also becomes a subsidiary record of the securities ledger, giving detailed information as to the date of deposit of securities with the transfer office, the date of withdrawal, the certificate numbers of the shares deposited and received, and the list of the securities in transfer. The securities ledger classifies by means of an alphabetical arrangement, while the transfer register groups the items under dates of deposit and withdrawal. By its arrangement it reveals at a glance just what stock has been transferred, what has been withdrawn, and what is still on hand at the transfer offices.

The Vault List

In many of the brokerage offices a record called a "Vault List" (Form 11) is kept to record the securities in the vault. This record is also subsidiary to the securities ledger.

The auditor will find it convenient to have this vault list when the point of reconciling the stocks on deposit is reached. He should not, however, depend upon the vault list, but should personally examine all securities in the safe deposit box and keep record of all changes which take place in the course of the day.

Revenue Tax Register

By the New York State law which became effective June 30, 1905, all shares of stock sold or transferred were made subject to a tax of 2 cents per share, regardless of par value. This law was subsequently amended so that the revenue at the present time is but 2 cents on each \$100 par value of stock transferred. The transfer offices, however, seldom requested the production of the stamps in effecting transfers, and the law was frequently evaded by using cancelled stamps to cover more than one transfer. To remedy this, an act was passed which made it compulsory for stock brokers to record all transfers, either through sale or re-registration. The face value of the stamps used therefor must also be stated. The book in which these entries are made is called the "Revenue Tax Register" and is shown in Form 12.

The revenue tax register provides space for the date of either sale or transfer of stock; the name of the stock; the number of shares (the quantity rather than the serial number of the certificate); face value (par value of the shares); and name of purchaser or transferee. The latter calls for the name of the purchasing broker or the person to whose name the certificates are transferred.

The special columns on the right of the revenue tax register are for the statement of the number and face value of the stamps used, and are designed to prevent the double use of transfer stamps.

Petty thieving of revenue stamps was not uncommon in the early days of the tax—something made possible by the system then in use, as no record of a probing nature was ever kept. The present revenue tax register—which is required by law—has overcome this tendency by providing the data for a checking inventory of such stamps. The consumed revenue stamps recorded by this register gives the consumption figure. Adding this to the physical inventory of stamps, the result should reflect the amount charged to the Revenue Stamps account in the general ledger at the beginning of the period.

Solicitors' Production Record

Where many solicitors are employed, it is necessary to keep a memorandum book of some sort which will reflect the margin of profit under which the solicitors are operating. Form 23 shows the form of solicitors' production record commonly used. This record should be so kept as to give a monthly review of each solicitor's commission-producing activities. Opposed to the solicitor's earnings for the house, is the amount of expense incidental to his employment, such as salaries, entertainment, and traveling expenses. As all contracts between a firm and a solicitor cover at least the period of one year, the record of business as shown by this memorandum book is valuable in considering the renewal of contracts.

ORDER OF ENTRY

Having examined into the books of account and the underlying records used in brokerage accounting, it will

be well to discuss for a moment the sequence or order in which transactions are recorded.

Purchases and sales are passed first through the purchases and sales book. At the same time the proper entries are made in the customers margin record. These are but pencil memoranda which trace the fluctuations on a given stock following its purchase or sale. If this were entered at a later time in the day, the chances are that some of the customer's margin might be well spent, making further call necessary before the close of the day.

The financial end of the transaction is now ready for entry in the blotter. If the customer deposits his margin upon the day of his commitment in the market, as is usually the case, then the ex-clearing house blotter of that day will evidence the fact by reflecting an appropriate credit. If, however, the transaction is of a clearing house nature and comes within the jurisdiction of the clearing house settlement, the clearing house blotter will express the transaction financially, and the item will be posted to the customer's account the next day. For instance, assuming that a purchase of clearing house nature was made on Thursday, July 15, then the clearing house blotter of Friday, July 16, will contain a record of the transaction. On July 16, the stock would be received through the Clearing House and funds would be paid to the broker whom the Clearing House designated as the delivering broker. This would necessitate an entry in the ex-clearing house blotter of July 16, attesting to the receipt of the shares and the parting with money. Of course, in this example it is supposed that the transaction is entirely financed by the purchasing broker.

To carry the illustration further, assume that the stock is taken to the vault and proper entry is then made on the vault list and in the securities ledger. The latter record recites the condition of the holdings, showing, say, that 100

shares of a certain named stock were bought for the account of "X," naming the vault as the place of deposit. If the stock had been transferred, the transfer stock register would attest the fact. If the stock was pledged as collateral, then the money borrowed book would show the place of deposit. If the shares had been loaned out in the Street, then, under the date of lending, the stock loan would be recorded in a financial manner upon the ex-clearing house blotter, and, for memorandum purposes, in the stocks loaned section of the stocks borrowed and loaned book.

In following the hypothetical transaction through the respective books which are affected by the transaction, the close relationship of one book to another is clearly seen. The records might be different, however, if for instance, the stock was not a clearing house listing, or if a different method of financing the transaction became necessary.

CHAPTER IX

THE CLEARING HOUSE SHEET

The Stock Clearing House

The discussion centering around methods of financing or settling Wall Street transactions would not be complete without a word as to the Clearing House system and the service which it renders the broker. So important an institution is it that the daily voluminous Wall Street transactions would be practically impossible without its aid.

As the Bank Clearing House facilitates the adjustment and payment of the many millions of dollars of debits and credits arising during a given day, so does the Clearing House of the New York Stock Exchange assist in the adjustment and delivery of the many hundreds of thousands of shares of stock purchased and sold daily among its members.

Because of this enormous volume of trading in certain securities, the Stock Exchange established its own clearing house in 1892. To illustrate the importance of its work, turn to the date of April 15, 1915, when over 318,000 shares of stock were traded in four issues alone, as follows:

- 63,500 shares of Amalgamated Copper
- 60,400 shares of Reading
- 39,800 shares of Union Pacific
- 154,675 shares of Steel common

These transactions represented values approximating \$28,000,000, to say nothing of the transactions in the other issues on that same day. In about four hours on the following day, April 16, all settlements—deliveries and receipts—were effected. It can readily be seen how great is the work of the Stock Exchange Clearing House.

The following list gives the securities which come under the jurisdiction of the Clearing House. They are known as clearing house listings. Opposite each appears the abbreviation used to indicate that security on the ticker tape.

Clearing House Stocks

Amal. Copper.....(C)	M. K. & T. Com.....(K)
Am. Beet Sug. Com.....(ABS)	M. K. & T. Pr.....(K PR)
Am. Can Com.....(CAN)	Missouri Pac.....(MP)
Am. Can Pr.....(CAN PR)	Nat. Lead.....(LT)
Am. Car & F. Com.....(AF)	Nevada Con. Cop.....(NV)
Am. Cotton Oil.....(AO)	N. Y. Central.....(CEN)
Am. Loco. Com.....(ALO)	N. Y., New H. & H.....(NH)
Am. Tel. & Tel. Co.....(ATT)	Norf. & W. Com.....(N)
Anaconda(ANC)	Norf. & W. Pr.....(N PR)
Atchison Com.....(A)	Northern Pac.....(NP)
Atchison Pr.....(A PR)	Ont. & West.....(OW)
Balt. & O. Com.....(BO)	Pacific Mail.....(P)
Balt. & O. Pr.....(BO PR)	Pennsylvania(PA)
Brooklyn R. T.....(B)	People's Gas.....(PO)
Cal. Pet. Com.....(CPU)	Press. Steel Com.....(PRS)
Can. Pac.....(CA)	Ray Consd. Copper.....(RC)
Cent. Lea. Com.....(CL)	Reading Com.....(RG)
Cent. Lea. Pr.....(CL PR)	Reading 1st Pr.....(RG I PR)
Ches. & Ohio.....(CO)	Reading 2nd Pr.....(RG II PR)
Chi. & N. W. Com.....(NW)	Rep. Steel Com.....(RBC)
Chino Copper.....(CY)	Rep. Steel Pr.....(RBC PR)
Col. Fuel Com.....(CF)	Rock Isl. Com.....(R)
Consol. Gas.....(G)	Rock Isl. Pr.....(R PR)
Corn P. Ref. Com.....(CR)	Rubber Com.....(RU)
Corn P. Ref. Pr.....(CR PR)	Smelters Com.....(AR)
Del. & Hudson.....(DH)	Southern Pac.....(SP)
Denver Com.....(D)	South. Ry. Com.....(SR)
Dist. Sec.....(DR)	South. Ry. Pr.....(SR PR)
Erie Com.....(E)	St. L. & S. W. Com.....(SS)
Erie 1st Pr.....(E I PR)	St. L. & S. W. Pr.....(SS PR)
Erie 2nd Pr.....(E I PR)	St. Paul Com.....(ST)
Gen. Electric.....(GE)	Sugar Com.....(S)
Gr. Northern Pr.....(GNR PR)	Tennessee Cop.....(TC)
Gr. Nor. Ore Ctf.....(ORE)	Texas Pac.....(T)
Great West.....(GW)	Third Ave.....(TAV)
Great West. Pr.....(GW PR)	Union Pac. Com.....(U)
Ice Sec.....(IS)	Union Pac. Pr.....(U PR)
Ill. Central.....(IL)	U. S. Steel Com.....(US)
Inter. Met. Com.....(IB)	U. S. Steel Pr.....(US PR)
Inter. Met. Pr.....(IB PR)	Utah Copper.....(UT)
Lehigh Val.....(LV)	Virginia Chem.....(VC)
Louis. & Nash.....(L)	West. Un. Tel.....(W)
Manhattan(M)	Westinghouse(WX)
Mex. Pet.....(MNP)	

The Methods of the Clearing House

Each member of the Exchange is entitled to clearing house privileges. Each broker who avails himself of this right, receives a number which appears on his "Clearing House Ticket," and also on his other clearing house documents.

For every purchase made on the Exchange there must be a bona fide sale, and both brokers—one buying for his customer, the other selling—must intend to receive and deliver the shares involved in the transaction. Every time a clearing house stock is dealt in, there is an implied agreement that the trade is to be handled in the customary way—namely, through the Clearing House.

One block of stock might represent a purchase of ten thousand shares bought from fifty respective brokers. The price of the stock might vary from one-eighth of a point to several points, depending upon the condition of the market at the time. It is a well-known fact that such huge purchases are consummated by a nod of the head or a discordant "bought" or "sold." In order to obviate any possible price differences in such "offhand" trading, each transaction is "compared" almost immediately after the close of the daily business. In ex-clearing house transactions, comparison may be made also before the opening of the market on the succeeding day.

Clearing house transactions are compared in the following manner: Slips called "Clearing House Tickets" are exchanged between buyer and seller, these tickets evidencing the quantity, description, and value of the shares sold. The seller's ticket, i.e., the ticket given to the purchaser by the seller, is a white one, the buyer's ticket, yellow. The seller's ticket has a perforated bill of sale attached to it, upon which the transfer tax stamp appears in cancelled form.

These tickets are in form and in fact orders on the Clear-

ing House to deliver, in the case of the seller, or to receive in the case of the buyer, 100 shares or multiples of 100 shares of a specified clearing house stock at the sale and purchase price shown on the tickets, the value of the shares being carried out in dollars and cents. It is obvious that where buyer and seller exchange tickets, the quantity, price, and money value should agree. If they do not, the matter is either adjusted before 4:15 P.M. on the same day, or else the shares are not passed through the Clearing House that night. The item is then settled out of the Clearing House or it may be treated on the following day's sheet.

The Clearing House Sheet

When the day's transactions have been completed, the clearing house tickets are written up on a sheet which is known as the "Clearing House Sheet." As shown in Form 13, this is divided into two parts: to the left, or the "Receive from" side, are five columns in which are entered the white tickets held by the concern which is preparing the sheet. In the first of these columns appears the broker's name; then, in order, the number of shares; the description of the stock which is to be cleared; the price of the purchase as it appears on the white ticket; and the money value thereof.

To the right of the clearing house sheet—the "Deliver To" side—information is listed from the yellow tickets which the concern holds and which were given it in exchange for its white or "deliver" tickets. In other words, the sheet when sent to the Clearing House by a broker, furnishes information to the authorities concerning his purchases and sales of the day, together with a list of stocks borrowed or returned. Hence, in the column reading "Deliver to," the broker compiling this sheet lists officially the orders which he makes upon the Clearing House, directing delivery of the shares involved. The other four columns

correspond to those on the left side, having the headings "Shares," "Stock," "Price," and "Amount."

At the bottom of the clearing house sheet the following directions appear: "Enter on this sheet only those transactions for which tickets have been exchanged," and, "The tickets must *agree* or both parties will be fined." This means an agreement as to the quantity, money value, and description.

Balancing the Clearing House Sheet

It will be remembered that the function performed by the Clearing House is to facilitate transactions in clearing house stocks between its members, by expediting the delivery and receipt of such stocks and by effecting settlement when so doing. In case receipt and delivery of the same kinds of shares appear on the clearing house sheet, the transactions are set off against each other when the clearing house sheet is balanced. This is done for the purpose of determining what is to be received from, and delivered to, the brokers whom the Clearing House may designate, the receipt and delivery to be actually made upon the following day.

Much in the same manner as a debtor or creditor bank pays or receives a bank clearing house certificate in settlement of its voluminous transactions, the broker receives or delivers, through his clearing house, the net shares purchased or sold, paying or receiving cash against them as the circumstances may require.

On the "Receive from" side of the clearing house sheet shown in Form 13, are listed:

- 100 shares of Amalgamated Copper
- 100 shares of Steel
- 100 shares of American Smelters

On the "Deliver to" side are listed :

200 shares of American Smelters

100 shares of Union Pacific

The only set-off is the Smelters stock to the extent of 100 shares, leaving as the "Balance to Receive," 100 Steel and 100 Copper. The "Balance to Deliver" is 100 Smelters and 100 Union Pacific.

Clearing House Deliveries

The question may arise as to how the Union Pacific and Smelters are to be secured by the broker for delivery. Probably he has the stock in his vault or elsewhere; or if these sales represent short sales, he will very likely borrow this stock the next morning to effect delivery. Wherever one customer is long of stock which is carried in the broker's vault or in bank loans, and another of the broker's clients has made a short sale, the broker is at liberty to use the long stock for the purpose of making delivery—in other words, he need not borrow that which is already available, but may hypothecate the securities of his customers.

Clearing House Delivery Prices

The question naturally arises when looking at the clearing house sheet, shown in Form 13, as to the prices at which the Copper and Steel are to be received, and as to the delivery price of the Smelters and Union Pacific. Let it be supposed that 5,000 shares of Copper had been purchased during the day at prices ranging from $76 \frac{3}{4}$ to 78. What price would then govern as the receiving price— $76 \frac{3}{4}$ or 78? If the broker elected $76 \frac{3}{4}$ as the settlement price, then the whole 5,000 shares could not be received at that price; some of it was purchased at 78. The same difficulty and haggling over settlement price would be expe-

rienced by each broker whose name appeared on the sheet. To prevent this difficulty, the Clearing House prints a set of prices on the stock ticker at about 3:30 P.M. each day. These prices, covering all clearing house issues, are known as the "Clearing House Delivery Prices." All net receipts or net deliveries, as evidenced by the clearing house sheet, are settled at these prices. All fractions are eliminated from the delivery prices, the price approximating the closing bid or offer on each clearing house item.

Referring again to Form 13, the net deliveries of 100 American Smelters and 100 Union Pacific which appear on the "Deliver to" side are carried over to the "Receive from" side opposite the side-head "Balance to Deliver"; while the net receipts are carried over to the "Deliver to" side opposite the side-head "Balance to Receive." When this is done, the total number of shares including the "carry-overs" will be 500 on either side. Furthermore, if the stocks are checked as to description and quantity, it will be found that they check by set-offs.

At this point the clearing house delivery prices are applied to the "Balance to Receive" and "Balance to Deliver" stocks. On the date given in Form 13, price for Smelters was 70; for Union Pacific, 162; for Steel, 67; and for Copper, 77. Hence, the Steel is received at 67 or \$6,700, and the Copper at 77 or \$7,700. The Smelters is delivered at 70 or \$7,000; and the Union Pacific at 162 or \$16,200.

The next step is to foot the two "Amounts" columns. In doing this it will be found that the credit side of the sheet totals \$44,650, and the debit side \$44,450—a difference of \$200 in favor of the broker whose sheet is shown. This excess represents the amount by which the Clearing House is indebted to the broker, and according to the rules he makes a draft on the Clearing House for this sum, the Manhattan Co. being the drawee. The draft will be bankable

if, after the sheet goes through (cleared), the manager of the Clearing House countersigns the instrument. If the sheet showed a balance against the broker, then a check made payable to the Manhattan Co. must be sent to the Clearing House at the time that the sheet is deposited.

Receive and Deliver Tickets

Reverting to the "Balance to Receive" and "Balance to Deliver" phases of the clearing house sheet, one other item is necessary before the sheet is ready for deposit with the Clearing House. To complete the sheet, there are attached to it clearing house tickets, known as "Balance to Receive" and "Balance to Deliver" tickets. The balance to receive tickets are made out for the bulk of each kind of stock which is to be received on net balance, and the balance to deliver tickets are made out for the bulk of each kind of stock which is to be delivered on the net balance. In the case of the sheet shown in Form 13, only two balance to receive tickets are necessary—one for 100 shares of Copper, and the other for 100 shares of Steel—while two balance to deliver tickets are necessary to evidence the broker's net delivery obligation—one for 100 Smelters and the other for 100 Union Pacific.

On the receive tickets the undersigned respondent broker advises the Clearing House that he "will receive the following balance of stock at the delivery price":

100 Copper at 77

100 Steel at 67

On the deliver tickets the broker states that he "will deliver the following balance of stock at the delivery price":

100 Smelters at 70

100 Union Pacific at 162

These four balance tickets are called for at the Clearing

House the following morning—Saturday excepted—and the face of the receive tickets will reveal the name or names of the brokers whom the Clearing House has designated as the delivering brokers, stating the number of shares which each one is to deliver. On the deliver tickets will appear the name or names of the brokers whom the Clearing House has designated as the receiving brokers. Between 10 A.M. and 2:15 P.M. all these balances are either received or delivered, thus settling the transactions. The smallest quantity of stock which is received or delivered through the Clearing House is 100 shares; no broker is called upon to settle fractional lots.

The Broker's Clearing House Balance

Before departing from the subject under review—the clearing house sheet and the balance tickets—let us consider the \$200 which was received from the Clearing House. Does this represent profit to the broker? The answer, in order to be well understood, must be given indirectly by means of the following explanation: Let us again refer, in Form 13, to the purchase prices of the Copper, Steel, and Smelters and compare them with the delivery prices as stated that day. The Copper was bought by X & Co. at \$7,675. By reason of the Clearing House price being stated at 77, X & Co. will have to pay \$7,700 instead of \$7,675, as would ordinarily be the case. The broker who sold this stock at \$7,675 would receive \$25 more than he would be justly entitled to. But he would, in switching his net delivery of 100 Copper to the receive side of his sheet, be compelled to use 77 as his clearing house price also. Deducting the lesser from the greater side, his sheet would reflect a debit to the Clearing House of \$25; while X & Co.'s would show a draft for this amount, provided that the Copper transaction was the only item cleared. There are, however, other transac-

tions shown on the sheet. The Steel purchase at \$6,662.50 is handled much in the same manner; but here \$37.50 is the amount so adjusted. The 100 Smelters bought at $69 \frac{1}{8}$ for \$6,912.50 is offset on the opposite side by 100 Smelters sold at $70 \frac{1}{4}$ for \$7,025, making a profit of \$112.50. It is quite obvious that X & Co. have a right to draw for this amount, for the reason that it happens to be the only way to collect the profit. Lastly, another 100 shares of Smelters was sold at $70 \frac{1}{4}$, which must be delivered at 70. In that event X & Co. would be underpaid by the receiving broker, but on this item also, the seller is entitled to collect from the Clearing House the difference of \$25. If the other transactions are followed out in like manner, it will be seen that the total of the four items aggregates \$200—the draft on the Clearing House.

If the sheets of other respondent brokers were analyzed with the purpose of determining the amount of X & Co.'s collection, it is safe to say that a reconciliation could be had very easily. In fact, the machinery of the Clearing House does just this analytical work to prove the correctness of all items appearing on the sheets. It must be emphasized again that a draft on, or check to, the Clearing House is a matter which is automatically adjustable and does not change by adding to or deducting from the real purchase cost or sale proceeds of transactions.

The two sides of the sheet are now in balance, for on the lesser side the draft for \$200 equalizes them. In preparing the sheet for deposit, the shares are checked up and footed. The clearing house tickets, balance tickets, and the draft all accompany the sheet.

CHAPTER X

BALANCING THE BLOTTERS

Balancing the Clearing House Blotter

The clearing house blotter, as stated in Chapter IV, is one of the two records from which purchases and sales are posted to the individual customers' accounts, the ex-clearing house blotter being the other. The clearing house blotter will also be referred to in its relation to the clearing house sheet. We shall now consider the method by which the clearing house blotter is balanced.

In reviewing the columnarization of the record (Form 14), we find that the first five columns on either side are practically identical with the first five columns of the receive and deliver sides, respectively, of the clearing house sheet (Form 13). That is to say, the column which provides for the name of the selling broker, under the caption "Of Whom Bought," corresponds to the column on the clearing house sheet which is headed "Receive from." Thus the name of the broker with whom tickets have been exchanged against purchases, appears again in this blotter. In the same way, in both forms the columns headed "Number of Shares" or "Shares," "Description" or "Stock," "Price," and "Amount," correspond and are self-explanatory.

In order that the clearing house blotter may operate as a check upon the sheet, all the transactions—the number of shares, nature of stock, and the amount involved, as evidenced by the sheet—must appear again upon the blotter. In effect, a copy of the sheet is preserved in blotter form, for in every detail the sheet and blotter agree.

The methods of balancing the clearing house blotter and

the clearing house sheet are so much alike that very little need be added to the discussion of the balancing of the clearing house sheet, in Chapter IX, other than the treatment of the information found in the blotter, not found on the clearing house sheet. For the purpose, we will take the transactions under the date of January 2, discussing them in connection with the clearing house blotter of January 3 (Form 14).

On that day the purchases were:

100 Copper, at $76 \frac{3}{4}$, for account of John Jones
100 Steel common, at $66 \frac{5}{8}$, for Fred Smith
100 Smelters, at $69 \frac{1}{8}$, for Richard Ross

The sales were:

200 Smelters, at $70 \frac{1}{4}$, for Richard Ross
100 Union Pacific, at 162, for Fred Smith

Reviewing these in the blotter, we find that the first five columns, as far as the purchases are concerned, express the transactions fully up to the point of cost to the broker, but the commission on the purchases increases the cost to the customers by \$12.50 on each hundred shares. The "Commission" column reflects this additional charge, and the "Total Amount" column combines the "Amount" and "Commission" columns. The broker's total commission on the 300 shares purchased during the day is \$37.50.

The sales, as far as the first five columns are concerned, bring the transaction up to the point of the proceeds received by the broker. From these the commission and tax must be deducted in order to arrive at the proceeds which are to be credited to the accounts of the customers. In the case of the Union Pacific the net proceeds would be, $\$16,200 - \$12.50 - \$2 = \$16,185.50$. In the same way, the proceeds of the Smelters sale would be, $\$14,050 - \$25 - \$4 =$

\$14,021. The "Commission" column totals \$37.50, and the "Tax" column \$6. The total commission earned on the 600 shares bought and sold during the day is \$75.

The first step in balancing the clearing house blotter is to foot the individual monetary columns of the receive page, which, if cross-footed, should equal the footing of the "Total Amount" column and thus prove the correctness of the work. In footing the deliver page, the correctness of the work can be established by adding the "Tax" and "Commission" columns to the footing of the "Total Amount" column, which should then equal the footing of the "Amount" column.

As a second step, the total commission shown on the receive page is carried into the "Commission" column on the deliver page. The total of the two is then carried to the "Total Amount" column, and the account to be credited with this sum is that of Commission. The total in the "Tax" column is treated in the same manner, the account credited being Revenue Stamps account.

The next step in balancing the blotter is the adjustment of the clearing house balances. The delivery prices are used on both pages as shown in Form 14, the respective amounts being entered in the "Amount" column and the grand total of these amounts being carried thence to the "Total Amount" column, the draft for \$200 being included. Under the caption "For Whose Account" appears "Clearing House." If all "Balances to Receive" and "Balances to Deliver" be carried over to the "Total Amount" column as shown on Form 14, and if all the columns be footed properly, then the "Amount" and "Total Amount" columns on the two pages must agree. The total number of shares must also agree on both pages and must agree with the footing of the shares columns on the clearing house sheet as well. A glance at Form 14 will show that such is the case with the transactions

given. The close relation between the clearing house blotter and the clearing house sheet is also clearly seen.

Before leaving the subject, it should be noted that the cross marks (x) appearing against the clearing house items, indicate that these are not to be posted to the ledger. The reason for this is quite apparent, if we but remember the rule that all clearing house differences—whether debit or credit—are self-adjusting. The balances appearing on the clearing house blotter are treated finally in the ex-clearing house blotter which is discussed below.

The Ex-Clearing House Blotter

One more record must be considered in its relation to the remaining stocks which are to be received or delivered—the ex-clearing house blotter (Form 16). All receipts of stock are evidenced on the debit side of this blotter; all deliveries, on the credit side. Hence, when the broker is to receive certain shares of stock through the Clearing House, he may look with certainty to the receive page of the ex-clearing house blotter to find the facts set forth. The same obtains in the matter of deliveries of clearing house balance stocks.

Referring again to the transactions of January 3, on the morning of January 5 the cashier enters on the proper page of his ex-blotter (see Form 16) the expected receipt of:

100 Copper at 77
100 Steel at 67

He will also make entry for the proposed deliveries of:

100 American Smelters at 70
100 Union Pacific at 162

The draft of \$200 which he made upon the Clearing House will have been collected and entered as a credit on the "Deliver" page. The customers for whom stock was re-

ceived against purchases, or those for whom delivery was made against sales, have already been charged with such purchases or credited with such sales through the clearing house blotter. Then the item in the ex-blotter, which attests to the receipts or delivery of clearing house balances, is entered as "Clearing House" account. No posting will be necessary to evidence the receipt or disbursement of cash for the charge or credit to the customer in the clearing house blotter, presupposing the exchange of cash in the transactions.

Further Uses of the Ex-Clearing House Blotter

Odd lots of stock, issues which are not listed on the Exchange, bonds of every description, and shares which do not come under the jurisdiction of the Clearing House, are all passed through the ex-blotter. When comparisons are made of purchases or sales, the delivery rules of the Exchange stipulate that all such transactions be settled upon the next delivery day. The securities are received and paid for, or delivered and collected upon. The customers' accounts are treated through this record. If a selling broker fails to deliver at the proper time, the item so failed upon is carried to the next delivery day, and the customer's account is charged when the stock is settled and paid for.

Balancing the Ex-Blotter

After the close of business, the ex-blotter in use that day is ready for balancing. The procedure is as follows: Foot the "Total Amount" columns, which comprehend cash exchanges of each page, after having treated the commission and tax items in the usual manner. These two items appear on the credit page. Then deduct from the credit footing the debit footing. The difference will represent the balance of cash in the banks at that time. A reconciliation is made by

proving the balance with the check books. Carry the balances to the "Receive" page, itemizing the respective balances in banks. Each bank is charged with the balance on deposit and credited in the succeeding day's blotter by a credit to it. Each day the new balance is debited to the bank account in the ledger. In this way a chain of balances exist which are always reconcilable with the check book and which can always be traced to the preceding day's blotter. That is, the ex-blotter of the succeeding day will contain, as a first item on the "Deliver" page, the bank balances of the previous night. As a last consideration in balancing the blotter, carry down the footings of the two "Total Amount" columns. These must be in agreement. The postings of the "Amount" columns need not necessarily agree, because they are not concerned with cash exchanges, the cash being received and disbursed in the "Total Amount" columns (see Form 16).

CHAPTER XI

TRANSACTIONS OF A STOCK BROKERAGE HOUSE—METHODS OF OPERATION

In order that the principles of brokerage accounting may be clearly understood we will now give a series of transactions representative of the average brokerage house, showing entries from the opening to the closing of the books of account.

Typical Transactions

Transactions typical of the business and occurring almost daily, may be summarized as follows: purchases and sales; borrowing; lending; returning; calling; renewal (of stocks borrowed and loaned).

The following transactions have a direct bearing upon purchases and sales, from the point of either financing or delivery: collateral bank loans; clearance loans; money loans (for financing transactions).

Other matters to be considered are as follows: interest and premiums in connection with money borrowed or loaned and stocks borrowed or loaned, which reflect costs and earnings pertaining to the general finances; commission and interest on customers' transactions which are additional factors affecting earnings; "mark-ups" and "mark-downs," as they affect stock loans; dividends credited or charged to customers; the interest on bond purchases or sales; and the custom of rendering monthly statements to clients and the computation of interest on such accounts.

Inception of a Brokerage Partnership

January 3, 1915, D. S. Hand, Carlyle Bird, and C. W. Boswell form a partnership under the firm name of Hand, Boswell & Co., for the purpose of conducting a stock brokerage business. Boswell contributes capital in the form of a stock exchange seat valued at \$50,000, and \$50,000 in cash. Bird contributes \$100,000 in cash. Hand contributes \$200,000 in securities, having an accepted value of \$190,000, it being the intention of the parties to regard the latter amount as Hand's contribution. The securities so given are as follows:

\$100,000, Union Pacific 1st 4% bonds, market value.....	\$95,000
50,000, United States Steel 5% bonds, valued at.....	50,000
50,000, Southern Pacific refunding 4% bonds, valued at.....	45,000
Total value of Hand's contribution.....	\$190,000

All profits and losses are to be distributed equally among the partners. Books of account are to be kept, all partners having access thereto. The depository is to be the Manhattan Co.

Opening Entries

The salient factors to be recorded in the opening entries relate to the capital contributions, and the first book of entry is the ex-clearing house blotter (Form 15). In this, under date of January 3, the following entries are made:

C. W. Boswell's capital account is credited with \$100,000, made up of \$50,000 in cash and \$50,000 as the accepted value of the stock exchange seat. On the debit side of the blotter, Stock Exchange Seat account is charged with a like sum, full details being given in connection therewith.

D. S. Hand's capital account is credited with \$190,000 and Securities account is charged with a like sum, the description of the securities received being given in detail. The

values as expressed on the debit side of the blotter are entered in the "Amount" column, in which are brought all transactions involving no cash exchange. Boswell's cash investment of \$50,000, together with any other cash items, is listed in the "Total Amount" column on the credit or "Deliver" page of the ex-clearing house blotter. The \$100,000 cash contributed by Bird is likewise entered in this "Total Amount" column. The ex-blotter at this point is balanced in the manner prescribed in the preceding chapter, and will show a cash balance of \$150,000—the amount for which the bank account is charged. (See Form 15.)

Customers' Purchases and Sales

On Saturday, January 3, the purchases for customers were as follows:

- 500 Steel, at 66, for account of J. Jones
- 100 Union Pacific, at 162, Fred Smith
- 200 Penn., at 119, R. Ross
- 100 Copper, at 67, A. Jessup

The sales of the day were:

- 2,000 Reading, at 167, account of A. Haskins
- 500 Smelters, at 70, B. Brown
- 800 Copper, at 71, John Rich
- 200 American Beet Sugar, at 22, J. Jones

The odd-lot purchases were:

- 10 American Can preferred, at 91, E. A. Clancy
- 30 Copper, at 70, E. P. Delano

The odd-lot sales were:

- 10 Union Pacific, at 164, E. Samuels
- 25 Brooklyn Rapid Transit, at 91, A. Baskin

The cash receipts for the day were:

\$2,500	from	J. Jones
1,000	"	F. Smith
1,000	"	R. Ross
4,000	"	John Rich
100	"	E. A. Clancy
250	"	A. Baskin

The purchase of 100 shares of Copper for the account of Jessup will be taken up by him. The purchase by Delano of 30 shares of Copper will be paid for and the stock delivered to him. E. Samuels will deliver 10 shares of Union Pacific against his sale. All the transactions will be settled on Monday, January 5, so that proper provision must be made for receipt and delivery.

Financing the Transactions

It is now necessary to figure the cost of the day's transactions for the purpose of determining what stocks, if any, must be loaned out or what securities the broker is able to carry on the strength of his own cash condition. It should always be borne in mind that conservative practice requires a comfortable balance to be retained at the bank. It would obviously be contrary to good business practice to allow the entire amount of cash on hand to be expended for the purpose of carrying customers' holdings. The value of all purchases of January 3 amounts to \$70,810. The bank balance, therefore, can easily provide this sum, so that it will not be necessary to lend stocks for the purpose of raising additional funds.

Borrowing Stocks against Short Sales

Let us now consider the stock-borrowing demands in order to enable the delivery against short sales. The purchases and sales book reveals a shortage of:

2,000 Reading
500 Smelters
800 Copper
200 American Beet Sugar

As these issues are all clearing house stocks it is expedient to borrow the shares from the "loan crowd" which assembles on the floor of the Exchange after the close of daily business. Assuming, then, that this is done, and that all the clearing house purchases and sales have been written up in the proper blotters, the next steps will be the preparation of the clearing house sheet and, simultaneously, the balancing of the clearing house blotter. Besides this, it will be necessary to note the borrowing transactions in the stocks borrowed and loaned book, giving full account of the name of the lender and the rate of interest on the stocks so borrowed. The securities ledger will contain a record of the purchased and borrowed securities, giving at once all necessary information.

On Monday, January 5, this being the day upon which the transactions of the 3rd are settled, the receipts from the Clearing House will be:

500 Steel
100 Union Pacific
200 Pennsylvania
100 Copper

Mr. Jessup, for whom 100 shares of Copper were purchased, remits \$6,712.50, against which is delivered a Street certificate for 100 shares of this stock. The receipt of cash from Jessup, together with the receipts from the Clearing House and the "odd-lot" transactions, are to be found in the ex-clearing house blotter of January 5.

Odd-Lot Transactions

A word is necessary here to explain the manner in which short sales in odd lots are treated. According to the purchases and sales book in which such listings are recorded, the broker will be called upon to deliver 25 shares of Brooklyn Rapid Transit. These shares are not available for delivery, owing to the fact that A. Baskin sold short and the stock could not be borrowed. Hence, unless demand is made, the seller will "fail" thereon. Usually such short sales of odd lots are covered, or bought in within a day or two, so that the failure for that length of time is often tolerated by the purchasing broker.

The 10 shares of Union Pacific sold at 164 for the account of E. Samuels, have been received, thereby allowing their delivery. The 30 shares of Copper purchased at 70 have been transferred to the name of E. P. Delano, he having paid \$2,103.75.

Routine Records

The stock transfer register is necessarily called into use at this point, to evidence the deposit of stocks with the transfer office. The customers' and other accounts found in the clearing house blotter are posted to the ledger or ledgers. If a customers ledger be operated, then only the Stock Borrowed, Commission, and Revenue Stamps accounts will be posted to the general ledger. If only one ledger is in use, then all the transactions are posted to the general ledger. This obviates, of course, the introduction of a private ledger, which if used, would contain the nominal accounts, such as "Commission" and "Interest."

The Revenue Stamps account is credited with the amount of tax stamps consumed in the process of stock delivery. This presupposes an expenditure for revenue stamps which, when purchased, are charged to this account. The revenue

stamp register is also called into operation, expressing the transfer of stock by sale of the securities dealt in on January 3.

The vault list further evidences the deposit of the stocks in the vault, the securities being in possession of Hand, Boswell & Co. These securities are being carried by them for account of their clients.

Customers Margin Book

The customers margin book is the only record which has not been treated in connection with the transactions of January 3. Turning to the margin sheet of B. Brown, it will be found that he is short of 500 shares of Smelters at 70. If, for purposes of illustration, we assume that the closing price of Smelters was 75 (this being the last price of the day), then the account will reflect a market debit approximating \$2,500. This debit is arrived at in the following manner: B. Brown will at one time or another be compelled to purchase this stock against his shortage. If 75 was the price at which he could have covered, then he would have lost 5 points on 500 shares, or \$2,500. To this paper loss must be added the amount of commission and tax. Very obviously, Brown has been extended a credit upon which he is operating in the market. If in the judgment of his brokers he is not sufficiently strong to carry his commitments further, then a request for market margin will be made. This market margin will tend to adjust the difference between the price at which Brown sold and the present market price.

The account of John Rich is an "original" margin account and the treatment differs somewhat from credit accounts. Rich is short of 800 Copper at 71, against which he has deposited \$4,000, or 5 points on each 100 shares. If the broker has reason to believe that the margin is ade-

quate, then no call for further margin is made. On the other hand, let it be assumed that Copper had risen to 73. Rich would have but 3 points and a request might be made for \$5,600 or 7 points additional on each 100 shares. Then the account of Rich will be well margined, for a margin of ten points is considered ample.

The account of A. Haskins does not require comment as it is similar to the account of B. Brown.

J. Jones is long of 500 Steel and short of 200 American Beet Sugar. From the standpoint of margins, the one sheet is all that is necessary to determine his standing in the market. Assuming that the price of neither Steel nor American Beet Sugar has changed, the net interest in this case is 300 shares long. Since an original margin deposit of \$2,500 has been made on this account, Jones will have an equity of approximately 8 points, or \$2,400, to margin the 300 shares.

In the case of Fred Smith the price of Union Pacific has advanced 3 points so that the account has a margin of \$1,300 or 13 points on 100 shares.

As Pennsylvania stock is of the par value of \$50, it is commonly referred to in the Street as "half stock." A purchase of 200 shares at 119 would therefore amount to \$11,900. For marginal purposes 200 shares of "half stock" is considered as 100 shares of stock whose par value is \$100. Thus R. Ross' account would have a margin of 10 points, it being assumed that the market price is unchanged. The margin accounts of Clancy and Baskin are comparatively simple and require no comment.

The entry of the foregoing completes the record of transactions of January 3. The work involved in the entries described is usually distributed over the various departments in the office so that it is completed at about noon of each day.

Call Loans

The ex-clearing house blotter of January 5 reflects a sufficient surplus of cash to warrant lending a part of it on "call." The floor member of the firm is therefore instructed to lend, say, \$50,000 at the prevailing interest rate. The name of the borrower and the nature of the securities by which the loan is secured are now entered on the receive page of blotter, and the amount loaned out is shown in the "Total Amount" column. The account charged is "Money Loaned."

These demand loans, or call loans as they are sometimes designated, are never made for a less amount than \$5,000. The interest is usually paid at the time the loan is liquidated, and when paid is charged to Interest on Money Borrowed account if funds had been borrowed, or credited to Interest on Money Loaned if funds had been loaned.

Final Entries

The final operation in the day's work is the balancing of the blotter, bringing down on the receive page the balance of cash with which the bank is at once charged. It is evident, therefore, that the bank accounts appearing in the general ledger, together with any petty cash, comprise the usual cash account. The bank balance is immediately carried to the deliver page of the next day's ex-blotter, so that the amount charged to the bank on the 3rd will be credited to the bank account on the 5th, and the new bank balance of the latter day is charged as heretofore.

The bookkeeper posts all entries to the respective ledger accounts under the date of January 5. The purchases and sales of January 3, together with the cash transactions appearing under that date, are now fully settled.

CHAPTER XII

TRANSACTIONS OF A STOCK BROKERAGE HOUSE—PURCHASES AND SALES

The Daily Routine

The following purchases and sales were made by Hand, Boswell & Co., January 5:

Purchases:

- 25 Brooklyn Rapid Transit, at 88, A. Baskin
- 500 Smelters, at 66, B. Brown
- 3,000 Copper, at 68, John Rich
- 500 Steel, at 65 $\frac{3}{8}$, J. Jones
- 200 American Beet Sugar, at 19, J. Jones
- 10,000 Reading, at 165, A Haskins
- 600 Penn., at 118 $\frac{1}{4}$, R. Ross
- 5,000 Union Pacific, at 158, B. Dick
- 600 Anaconda, at 36, I. Eakan

Sales:

- 500 Distillers Securities, at 19, C. Ridge
- 400 Illinois Central, at 110, R. Ross
- 700 New Haven, at 67, B. Brown
- 200 Penn., at 117, B. Axel
- 600 Rubber, at 59, A. Jessup

A review of the above transactions will show that the 25 shares of Brooklyn Rapid Transit sold January 3 by A. Baskin were "covered" or bought back. Thus, while the broker failed to deliver this stock within the delivery time, he is now prepared to make delivery. When he receives the shares he will send them to the broker who is awaiting receipt.

Turning now to the 100-share transactions, we find that B. Brown covered his shortage of 500 Smelters. By purchasing 200 American Beet Sugar, J. Jones has covered his shortage. We also observe that John Rich purchased 3,000 shares of Copper, covering the 800 shares of Copper which appeared in his short account and thereby reversing his position in the market to the extent of 2,200 shares of the same stock. This makes Rich's account, technically speaking, long. The same holds true in the case of A. Haskins who purchased 10,000 Reading. Being formerly short of 2,000 shares he has reversed his position in the market, going long 8,000 shares. In the cases of both Haskins and Rich, new ledger accounts showing the present longs will be necessary. Their short accounts will be charged with the number of shares representing the shortage, and the long accounts will be charged with the remainder.

Borrowed Stock

On January 3, in order to make possible the delivery against short sales, Hand, Boswell & Co. were compelled to borrow:

2,000 Reading	
500 American Smelters	
800 Amalgamated Copper	
200 American Beet Sugar	.

It is quite apparent that when the brokers' customers cover their shortages, the brokers will, upon receipt of the shares so purchased, be in a position to return this borrowed stock. Accordingly, Hand, Boswell & Co. having no further use for the stock, inform the respective lending parties that they will "return on the sheet of today," the above-listed borrowed stock.

Stock Returns

At this point a digression is necessary in order to explain the means by which stock returns are made possible. Stock loans in general are both "returnable" and "callable," provided reasonable notice is given to the other broker. Loans involving clearing house issues are settled on the clearing house sheet. Thus a return of a clearing house stock necessitates an exchange of clearing house tickets. On the sheet the returns are treated in the same manner as a sale, for the reason that an order is therein given to the Clearing House to deliver certain shares.

Whenever stocks are borrowed, cash is paid; and conversely, whenever stocks are loaned, cash is received. As the broker loaning the stock profits from the use of the money which he receives against such loans, he should pay interest at the agreed rate. Taking a concrete case, let it be supposed that the 500 shares of American Smelters mentioned in the foregoing transaction, were borrowed at $2\frac{1}{2}\%$; that the clearing house price that day for Smelters was 68 (the clearing house prices being those which govern all stock loans cleared on the sheet), and \$34,000 the amount involved. If the stock were borrowed on the sheet of January 3, the transaction would go through on the 5th. If returned on the sheet of January 5, then the transaction would be settled January 6, and one day would measure the time on which interest at the rate of $2\frac{1}{2}\%$ is chargeable on \$34,000; the interest in this case being \$2.36. The amount on the clearing house ticket and likewise on the sheet would then read \$34,002.36.

On the other hand, let us suppose that this same loan extended over a period of 20 days and that the rate varied; the range being from 2 to $4\frac{1}{2}\%$. In that case, when

the stock was returned, the amount of interest would be arrived at in this manner (provided, of course, that these are the rates at which the stock was lending on the various days): $2\frac{1}{2}\%$ for 4 days + 2% for 5 days + 3% for 8 days + $4\frac{1}{2}\%$ for the balance of the time. The interest on the above transaction would amount to \$59.03, so that the clearing house ticket would read \$34,059.03.

Short Sales

Returning to the subject proper, we find by consulting the purchases and sales book that it will be necessary to borrow:

500 Distillers Securities

400 Illinois Central

700 New Haven

all representing short sales. Notice is served on the floor broker, or the clerk in charge, to do the necessary borrowing.

On this day 200 shares of Pennsylvania were sold for the account of B. Axel, but the sale is offset by the purchase of 600 shares of the same security for R. Ross. If no Pennsylvania had been so bought, delivery against the short sale could have been made by using the 200 shares of Pennsylvania which were deposited in the vault on the 3rd.

Cash Items

On the sale of 600 shares of Rubber by Jessup, delivery was promised by the customer, making this transaction one which is commonly referred to as a "cash item." This term, as used here, means in the case of a purchase that the customer will buy the stock outright, and that in the case of a sale he will actually deliver the shares to the broker.

Financing the Purchases

The next step is a consideration of the cash necessary to finance the customers' purchases. It would be almost impossible, in a work of this nature, to trace the daily margin deposits of customers in connection with their cash condition. It is sufficient to restate the general rule that on speculative transactions, credit customers are not called upon for original margins, but other clients are required to make adequate marginal deposits. In the set of hypothetical transactions of Hand, Boswell & Co., it is always to be inferred that a proper margin system is in operation and that all the usual margins have been received. If, as in the transactions of the 5th, the total of all purchases amounts to approximately \$1,500,000, and the cash condition of the firm makes it necessary to lend stocks to strengthen the finances, then the order will be given to lend a sufficient quantity of securities to secure the required cash. In regard to the money loaned out on call, the custom is that all such loans can be called before 1 P.M. on the day of demand. Needless to say, the money which was loaned out on demand will have been called the night previous, and be paid to Hand, Boswell & Co. the day after call. The element of interest in this case has already been touched upon.

For immediate needs in the case in question, it is found necessary to lend:

2,200 Copper
800 Reading
5,000 Union Pacific

All the stock loans will be passed on the clearing house sheet and in that way offset a certain amount of purchase, making the cash needs less urgent.

The following stocks can be received and paid for out of the cash balance remaining in the bank:

500 Steel
400 Pennsylvania
600 Anaconda

Premium and Interest on Stock Loans

In order to bring out the principle of premiums and interest on stock loans, let it be supposed that the 2,200 shares of Copper were loaned at $1/64$ premium, which means that not only is no interest paid on the money received on the security of this stock, but that the borrowers of the stock actually pay the lenders a premium of $1/64$ of 1% on the face value of the stock. Let us further suppose that the Reading was loaned "flat," which means that the stock is in great demand and therefore no interest is charged thereon, and that the Union Pacific was loaned at 2% interest.

Recording the Day's Transactions

The transactions of the day are now all passed through the customary books, the clearing house blotter being balanced in conjunction with the sheet. In this particular instance, the Stocks Borrowed account would appear on the credit page of the clearing house blotter to evidence the return of stock borrowed the night previous. The item of interest on the stocks returned would be entered in the "Interest" column; and in carrying the total of interest to the "Total Amount" column, the Interest on Stocks Borrowed account would appear under the appropriate heading. The Commission account will be credited with the commission earned, and Revenue Stamps account with the revenue stamps consumed by reason of the sales.

The stocks borrowed and loan book will evidence the return of the borrowed stocks, and the loaned section of the same record will state in detail the facts concerning the lending of securities.

The stock ledger, vault list, and customers margin book, together with the revenue stamp register, will express the changes in the condition of securities, the changes in customers' accounts, and the consumption of revenue stamps.

The ex-clearing house blotter will, in the case of the 25 shares of Brooklyn Rapid Transit, show the delivery of that stock. It will also record all subsequent transactions, such as the receipt of margin from customers, the calling in of the money loaned, and the interest thereon. In this case the interest account to be credited is that of "Interest on Money Loaned." This blotter is now balanced in the usual way and sent to the bookkeeping department for posting.

The Day's Transactions

Purchases on January 6 were:

500 Distillers Securities, at 21, C. Ridge
800 Illinois Central, at 112 1/8, R. Ross
700 New Haven, at 68 3/8, B. Brown

The sales in the same day were:

2,200 Copper, at 70, J. Rich
8,000 Reading, at 167 3/8, A. Haskins
5,000 Union Pacific, at 160 5/8, B. Dick

On the previous day, stocks borrowed against shorts were:

500 Distillers Securities
400 Illinois Central
700 New Haven

A return of all these borrowed items is made possible this day by the covering thereof.

The brokers, in order to raise funds on the previous day, faced the necessity of lending:

2,200 Copper
8,000 Reading
5,000 Union Pacific

The Call and Return of Stocks Loaned

Subsequently, the brokers are called upon to deliver like quantities of these same shares by reason of the day's sales. Then, in order to make a delivery, they will call the stocks which were loaned (these being cleared on the sheet); that is to say, they will request the return of the 2,200 Copper, 8,000 Reading, and 5,000 Union Pacific.

As these are clearing house listings, there is the usual inference that they are to be passed through the Clearing House. In that event, the sales of the day would be opposed on the receive side of the sheet by stocks similar in quantity and nature, which are being returned to the house by various other brokers.

On both the call and return of stocks, interest is computed for the length of time that the money has been used. In the case of the called stocks, three distinct conditions may exist—the stocks may have been loaned at a premium, a flat rate, or at interest. Turning to the loaned section of the stocks borrowed and loan book we learn that the Copper was loaned at a premium of $1/64$, i.e., $1/64$ of 1% on the face value of shares, or, as the rate per day per hundred shares, \$1.56, always excluding Saturdays and Sundays. Therefore, the premium on the 2,200 shares of Copper for one day would be \$34.32. The broker who is returning the money will deduct \$34.32 from the prin-

cipal of the loan. In other words, the Copper shares having been loaned at 70, his clearing house ticket would read: 2,200 Amalgamated Copper, \$153,965.68.

The premium*on these 2,200 shares of Copper represents an earning, and in order to effect a credit to the Premiums account, the sum must be carried to the credit side of the clearing house blotter under the appropriate heading. The Stocks Loaned account which is charged in this case, will apparently contain a discrepancy to the extent of \$34.32. This point may perhaps be more clearly expressed by saying that the "Amount" column on the receive page of the clearing house blotter, will contain a charge of \$153,965.68. If to this sum is added \$34.32 and the total thereof carried into the "Total Amount" column, then the Stocks Loaned account will be properly charged with \$154,000, representing the loan value of 2,200 shares of Copper.

In the case of the Reading, the stock was loaned flat; hence it will be returned without the introduction of the usual interest factor. The stock was loaned for \$660,000 and is returned against the same amount of money.

The Union Pacific stock was loaned on January 5 and called on January 6. One day is the elapsed time on which interest at the rate of 2% is charged. The principal being \$790,000, the interest thereon would be \$43.89. This interest is charged to Interest on Stocks Loaned account.

Interest on Stocks Loaned

If stocks which have been borrowed or loaned are neither returned nor called for a considerable period, then the interest rate might vary from day to day, depending upon the prevailing loaning rates of stocks. It is to the advantage of the lender to reduce the interest rate whenever possible. The converse is true in the case of the

borrower. In the one instance a lower rate means a smaller payment for the use of money obtained on the stocks loaned, while the borrower of the stocks will earn more if he renews the loan at a higher rate of interest.

On some days call money is higher; on other days lower. Unless there be a short interest in the market (which in turn means a great demand for stock borrowing), the rate at which stocks will loan will be governed largely by call money conditions. If the original loaning rate on Steel was 4%, and it falls to 3 1/4%, then in order for the lender of stocks to reap the benefit, he must notify the borrower that the rate on his Steel is renewed at 3 1/4%. If, on the other hand, the loaning rate of Steel rises to 5%, then it is necessary for the borrower to serve notice on the lender that the renewal rate has increased to 5%. Unless such notice is given by the borrower or the lender, neither has the right to change the rate from that which prevailed on the last renewal day. These matters of renewing, etc., are attended to each day after 3 P.M.

It should be stated here that the borrowing and lending of securities, and therefore the rate of interest, have absolutely no bearing on the customers' accounts other than that they control the interest with which customers are charged at the end of each month.

Collateral Bank Loans

Frequently there exists no borrowing demand for securities. More often, inactive issues are in no demand whatever. Under such circumstances, money cannot be had on the usual stock loan. Bonds are very rarely sold short, and seldom, if ever, figure prominently in the activities of the loan crowd. How then are the purchases of inactive issues and bonds to be financed? Relief is to be

found in the collateral bank loan. The banker or broker who lends on collateral security generally desires a high grade of collateral, i.e., securities having a ready and available market. Industrial stocks usually will lend at a slightly higher rate than will railroad stocks or first-class bonds. Sometimes a mixture of the two is acceptable, while at other times the money lender will refuse the loan unless a better kind of security be given. Some industrial stocks will loan at 60% of the market value, while railroad stocks and bonds will command 80%. If a purchase of a poor class of security be made, the marginal requirements should be gauged by the amount of money which that particular security could realize if it were pledged in a collateral loan.

It is to be observed that most collateral demand loans are of short duration, most of them running under 30 days. The call money rate on these loans varies. Here again, the lender is charged with the duty of notifying the borrower when he wishes to increase the rate. Likewise, the borrower, when the rate decreases, must notify the bank and arrange with it for the lower rates.

Time Loans

Collateral loans are made also on time, the usual period being 30, 60, or 90 days. Time loans are made at a stated and permanent rate of interest. The interest is generally settled at the time of payment, but in some cases the lender will request the payment of such accrued interest at the end of each month. The point in connection with accruals from the borrower's standpoint, will again be treated under the income statement (Chapter XIV).

Coupons

When coupon-bearing bonds are deposited as collateral

security, maturity coupons belong to the owner of the bonds; and whenever a coupon day arrives, the borrower should request the bank to cut the matured coupons from the bonds and deliver them to him or collect them for his account, as he may desire.

Equity in Collateral Loans

In a rising market the equity which the borrowing broker has in his securities is increased, and sometimes to such an extent that he may withdraw some of the collateral. In a declining market the equity is decreased and the broker is very often called upon to deposit additional security.

Clearance Loans

Brokers in general have excellent banking connections. The relation between banker and broker is so close that usually the former is kept well apprised of the latter's business conditions and stability. Where this is the case, the "clearance loan" is a common method of meeting the broker's financial needs.*

On some days the receipts of securities assume large proportions. The broker knows before 10 o'clock each morning the amount he will need to carry him through the day. His balance is seldom large enough in itself to cope with a day of extremely large business. To meet such a condition he will perhaps give his bank a note for a sum large enough, in connection with his own balance, to pay for all securities to be received by him, that day. He, then, during the day arranges for a demand or a time loan to provide more permanently for the securities paid for through the medium of the "clearance loan." At the

*For an interesting discussion of the clearance loan, and the Hocking Coal and Iron decision affecting these loans, see the *New York Mail* for November 12, 1913.

end of the day he deposits a sufficient amount of money to liquidate the clearance loan, and the transaction is complete. At least 50% of all stock purchases by brokers are financed by means of these temporary clearance loans.

The Mark-Up and Mark-Down

The "mark-up" (market up) as explained briefly in Chapter VI, is a notice of an increase in the price of stocks issued by the lender of these stocks to the borrower. If the market rises very rapidly, such adjustments will be frequent. In fact a given stock, in a widely fluctuating market, might be adjusted to market value several times during a day.

The mark-up operates in favor of the lender because it gives him a greater amount of money on his stock. On the other hand, it works against him from the standpoint of interest, for the larger the principal borrowed, the greater the amount of interest to be paid thereon.

The "mark-down" (market down) is a notice of a fall in the price of stocks given by the borrower of such stocks to the lender. The mark-down is a feature of a declining market and operates in favor of the borrower by reason of his receiving back part of the principal which he has given in exchange for the borrowed stocks. But the mark-down also operates against him from the standpoint of interest, for the reason that while the principal is being continuously decreased by the mark-downs issued by him, the interest received is also being decreased in like proportion.

Both mark-ups and mark-downs are issued between 10 A.M. and 3 P.M. From the standpoint of the blotter, they are handled in the following manner:

In the case of the mark-up, the broker who is lending the securities will charge "Stocks Loaned" (regardless of

the nature of the stock) with the amount of the old principal, making due allowance for interest charges, and will credit Stocks Loaned with the new principal which represents the increased market value.

The mark-down is treated in practically the same way. But here, the broker issuing it is borrowing securities. The Stocks Borrowed account will therefore be credited with the old principal, making due allowance for all interest charges, while the same account is charged with an amount representing the new market value of the issues.

In the case of a mark-up, the borrowing broker gives the lender a check for the difference between the old principal less the interest to which the former is entitled, and the new market value of the stock. This interest, on the books of the broker "marking up" is charged to the account of "Interest on Stocks Loaned." The same interest, from the standpoint of the borrowing broker, represents an earning, and is credited to Interest on Stocks Borrowed account.

All changes due to a mark-up or a mark-down must be reflected in the corresponding sections of the stocks borrowed and loaned book. Either has the effect of a new transaction and is treated as such.

Interest on Bonds Purchased or Sold

Bonds are traded in on the Exchange—"and Interest"—the purchasing broker paying interest on the principal from the last coupon date. To illustrate, let it be assumed that a \$1,000, 5% bond, with interest payable January 1 and July 1 of each year, is purchased July 31 at 99 $\frac{7}{8}$. The amount which the broker will pay on this purchase is \$998.75 plus the interest at the rate of 5% for 30 days on the principal of \$1,000. The broker's customer is charged with the total of these two amounts plus the com-

mission of \$1.25 on each \$1,000 bond. The same method of calculation is used in the case of a sale, but here the customer receives the total of the first two amounts less his broker's commission. There is no charge for revenue stamps on bond sales.

Dividends on Stocks

Only stockholders of record are entitled to dividends. That is, only such stockholders as have had their stock registered in their own names will receive payment of dividends direct from the corporation which issues the stock. To meet this condition, it is customary for the broker to transfer into his own name all stocks carried by him. For instance, a broker holding 500 shares of Steel common for various speculative accounts, would cause a transfer to be made which would make him the registered holder of 500 shares of common stock on the transfer and stock books of the United States Steel Corporation. The shares in this form are considered a good delivery. By good delivery is meant that certificates bearing a "stock exchange" indorsement are more readily acceptable in the Street than are non-stock exchange indorsements.

Whenever a stock is about to sell ex-dividend, notice thereof is printed on the ticker. All transactions thenceforth are made with the dividend off. The price of such a stock frequently reflects a decrease to the extent of the dividend. For example, if Steel were marked ex-dividend, John Jones could then buy 100 shares at 55 instead of 56 $\frac{1}{4}$, but he would not be given credit for the dividend when it was subsequently paid.

Customers carrying "long" stock before declaration of dividends, and who do not dispose of their holdings before the time that the stock sells ex-dividend, receive credit for the dividend on the day that it becomes payable.

Thus, if a customer is long of 500 shares of Steel on which the quarterly dividend of $1\frac{1}{4}\%$ is declared and payable, his account is credited with \$625, representing the quarterly dividend of $1\frac{1}{4}\%$, or \$1.25 per share. The cashier's department keeps a dividend memorandum book containing the names of customers entitled to dividend credit.

The effect which a dividend declaration has on stocks—if sold ex-dividend—is a depression in price. Any customer who is short at the time a stock sells ex-dividend, is charged with an amount representing the dividend. That this is equitable is quite apparent, for, unless the charge be made, the customer could cover his shorts at the decreased price, thereby gaining in the operation. The converse of this gives the reason for crediting dividends to "long" customers. If the latter dispose of their holdings while the dividend is off, they will lose in the transaction.

To illustrate, the broker's books might contain both long and short accounts in Steel. The credits on such longs and the charges against such shorts will be made by journal entry through the blotter. For example, if Brown is long of 100 Steel, and Jones is short of the same amount, then Brown receives credit in the "Amount" column for \$125, while Jones is charged the same amount.

A question might be raised here concerning the dividend on the 100 shares long. If the broker registered this stock in his name, then he would receive any dividend paid on it while the stock was so registered. If, however, sales were made necessitating the delivery of these shares, and such delivery was made to the purchasing broker while the books were still open, it is safe to say that an immediate transfer by the purchaser would follow, whereby the dividend would be sent to the latter. If the sale were made before the stock sold ex-dividend, and no

time remained for a transfer, then the check would be sent to the broker in whose name the shares were registered. In such case, this latter would give a due bill for the amount of the dividend to the broker who purchased the Steel.

Due Bills

The "due bill," mentioned above, is a form of note wherein the person receiving the dividend from the corporation promises to pay its amount to the person who is entitled thereto, and at such time as the same becomes payable.

The "Due Bills Receivable" account represents items of this nature that will be received whenever the dividend payments are made. It is supported usually by a schedule which for each item gives the names of the brokers from whom payment is expected, the description of the stock, the number of shares, and the name of the customer who is to be credited with the dividend. The Due Bills Receivable account is charged with each item, and the customers credited with the sum to which each is respectively entitled. Also, a "Due Bills Payable" account appears on the books to evidence any similar liability to other brokers for unpaid dividends.

When stocks are borrowed against short sales of customers, such securities represent the long interests of the lending broker. If the stock were loaned before ex-dividend time, the chances are that the certificates have been transferred into the name of some other broker in the Street. Nevertheless, the lender has a right to any dividend declared on such stock, and looks to the borrower for the payment thereof. For the borrower, on the other hand, such stock represents a short interest. The customers short of the stock are very frequently charged

with the amount of the dividend as soon as it is declared, for the reason that the liability is established at the time of declaration. The Due Bills Payable account is credited with these dividends in a lump sum, and is supported by a schedule as in the previous case. This underlying statement recites the name of the broker who is to be paid, the description of the stock, the number of shares, and the customer who is charged therewith. Usually the broker issuing the due bill charges 1% for collection.

All dividend stocks appearing in the securities ledger should be kept in sight, so that when notice of a dividend on any stock is received, the long and short accounts in that security may be segregated and the proper action be taken in regard to the dividend.

CHAPTER XIII

TRANSACTIONS OF A STOCK BROKERAGE HOUSE—CUSTOMERS' ACCOUNTS AND STATEMENTS

Monthly Statement

It is the practice among brokers to render monthly statements to all customers. This statement is not to be confounded with the memorandum of purchase or sale, which is sent to the customer after the execution of an order.

The ruling of the monthly statement (Forms 17, 18, and 19) provides for the date, explanation, amount, and total amount; also a column for the number of days for which interest is charged, and a column for the amount of interest on each transaction. The debit and credit sides are alike in form.

After the net interest to be charged or the customer's credit is arrived at, it is journalized through the blotter and posted to the customer's account. From there, it is carried to the statement. At the top of the statement a space is provided for recording the interest rate at which the charges and credits have been figured.

Interest Charges

The rendering of monthly statements involves two important operations: (1) the determination of the items on which interest is to be charged; and (2) the computation of interest.

These operations can best be illustrated by taking concrete cases. For the purpose, let us take the account of John Jones, who, on January 2, purchased on credit 100 Union

Pacific at 168, and sold the stock on January 9 at 169 $\frac{3}{8}$ (see Form 17). For 7 days this was a long account. It was a simple account for the reason that it contained no facts of opposite tendencies. If on January 10, Jones requested a check in settlement, then the interest charge would be determined that day. Supposing the rate to be 6%, the interest in this case would amount to \$19.61, i.e., the interest for 7 days at 6% on \$16,812.50; and Jones would be charged with this amount. The interest period is obtained by taking the elapsed number of days between the date on which the Union Pacific purchase is charged and the date on which the proceeds of the sale are credited. Assuming that January 2 was Monday, the day of settlement would be Tuesday, January 3. The date on which the proceeds were credited was the 10th, consequently seven days is the interval for which interest is chargeable.

Interest charges against customers are credited to an account known as "Interest on Customers' Accounts." As customers are not usually in the habit of settling their accounts at irregular times, the lump sum of interest charges is usually credited at the close of each calendar month. This total amount of interest is the result of many different operations performed in connection with the customers' statements.

When we come to interest allowances to the customer, we find that at times he is long, while at other times he is either short or hedged. If on his long transactions he deposits margin, then the account is entitled to a credit for the interest on this margin. Thus, if John Jones made a payment of \$1,000 on January 3 (as assumed in Form 18), he would be allowed 7 days' interest on this amount at 6%, and his credit balance January 10 would amount to \$1,092.06 (debits, \$16,812.50 + \$19.61 interest; credits, \$1,000 + \$16,923 + \$1.17 interest).

Suppose further, that on January 15 Jones purchased 100 shares of Copper at 68. The time between the last transaction and this one would cover a period of 6 days. During this time Jones' credit balance would remain unchanged, and according to the custom which prevails, he would be allowed interest at the rate of 2% on this balance (\$1,092.06) for a period of 6 days. Then, if the Copper purchase were carried to the end of the month or longer, the bookkeeper would compute and enter the interest against Jones up to January 31.

To review the case in point as to both debit and credit charges, computation would be, first, \$16,812.50 for 7 days at 6% ; then the credit of \$1,000, representing the margin deposit for 7 days at 6% ; then 6 days' credit at 2% on the new credit balance of \$1,092.06; and last a charge for 15 days on \$5,702 at 6%. In other words, the interest charges are arrived at by considering the daily balances. On all debits a fair rate is charged, based on the call money conditions, i.e., upon the average "call money" rate which the broker pays for the use of funds. On credits 2% is allowed; this upon the theory that the customers' money is worth only 2% to the broker, since small amounts cannot be loaned out at a greater earning.

No interest is usually allowed on "short accounts," excepting on deposits treated as margin. In this case a nominal rate of 2% is allowed. Where a customer is long and short at the same time—a hedged account—he is charged with interest on his long commitments; and allowed no consideration on his short transactions unless they are margined. This presupposes separate long and short accounts in the ledger.

One feature peculiar to short accounts must be mentioned here. The very large speculative accounts containing heavy short interests are a source of earning to the broker from the

interest received on borrowed stocks. It is quite conceivable that no personal outlay is made in the case of a short sale, for with the money which the broker receives against delivery, he finances his borrowing operations. On this borrowed stock, interest is earned in such quantities that some concerns make it a practice of dividing it with the customer. This, however, is not effected by the methods explained, but rather by a distinct journal entry, charging "Interest on Customers' Accounts" and crediting the short account of the customer.

Relation between Accounts and Statements

Referring again to the account of John Jones (Form 18), the balance brought down under date of January 31 is a debit of \$5,734.33, and on the line below appears "Long, 100 Copper." If this customer did not trade again until March 1, then 28 days of interest at the prevailing rate would be charged on the debit balance. Thus interest is really compounded. The same method of balancing the customers' accounts obtains in the case of short accounts, but the balance brought down appears on the credit side and a list of the short stocks is given.

Coming back to the customer's monthly statement, it might be added that an account is rendered stating all short transactions, and also one reflecting all the long commitments. The ledger account and the statement must agree in every particular, which means that the long stocks carried down together with the balance must agree with the statement. The agreement between statements and accounts will be seen if the three monthly statements, Forms 17, 18, and 19, are compared with the three customers ledger accounts shown in Forms 20, 21, and 22.

CHAPTER XIV

TRANSACTIONS OF A STOCK BROKERAGE HOUSE—CLOSING THE BOOKS

Income

Income in a brokerage business is derived from:

- Commissions
- Interest on customers' accounts
- Interest on stocks borrowed
- Premiums

Expense

The expense items in a brokerage business may be divided into general expense and solicitors' expense.

General expense embraces the following:

- Rent
- Office salaries
- Telephone
- Telegraph
- Ticker service
- Stationery
- Printing
- Postage
- Stock Exchange dues
- Clearing house fees
- Purchase of manuals
- Market reports
- Financial systems*
- Advertising (in periodicals and trade journals)

*Systems such as supplied by Babson or Dow Jones.

Solicitors' expense includes :

Entertainment of customers

Salaries of solicitors or agents

Traveling expenses

Very often, in the conduct of branch offices, the keeping of separate income and expense accounts is required, to measure the productivity of business coming from them.

Omitted Expenses

One important consideration in closing the books of a brokerage concern is the accounting for certain liabilities not usually evidenced by the books. The care which is exercised in accounting in other businesses does not mark the broker's office, and it is not usually a place where scientific methods are followed in connection with the peculiar accounting system employed. Often the broker does not enter at all the many invoices which he receives for miscellaneous services and supplies, such as stationery, printing, telephone, telegraph service, and the like; nor is he apt to accrue interest, salaries, or rent. Under these circumstances, the great majority of financial statements prepared by brokers contain nothing but cash factors. This practice is wrong and is badly in need of correction.

The broker is engaged in business for the purpose of making a fair return on his capital. It would be of interest and of value to him to know the cost incidental to the purchase or sale of each 100 shares of stock; what the volume of business was, and how much was made during the year. Such information, if available to the administrative head of a business, determines his future business policy, thus making for efficiency and increased profits. For this reason special attention is given here to the so frequently neglected items of cost referred to above.

Accruals

Many concerns overlook the importance of accruals, because the business, for the most part, is conducted strictly on a cash basis. This, however, does not justify the neglect of accruals, for in the face of all statements in the Street to the contrary, the true condition of any concern cannot be determined without the aid of certain and absolute accounting principles, and these require the proper consideration of accruals when the books are to be closed.

Interest on interest-bearing notes receivable should be accrued, and these earnings be reflected in the period's profits. The same rule should govern in the case of interest from stocks borrowed, money loaned, or the earnings from stocks loaned at a premium.

Also, in connection with income factors, it might be added that all interest on bonds owned should be accrued and brought into the income statement. The interest on customers' accounts should also be given proper consideration.

Salaries should be accrued and the corresponding liability accounts set up. Rent, and interest on stocks loaned and money borrowed should be treated in a similar manner. Any interest arising in connection with notes payable which the broker may have outstanding, should also be included.

Reserve Accounts

Usually the capital contributions of a brokerage concern will include securities whose value changes one way or the other during the accounting period. If the securities have risen in value, conservative practice does not permit the writing up of the asset for the purpose of increasing the earnings. If, on the other hand, the value has depreciated, then ample provision should be made for such depreciation, the usual reserve account being credited for the purpose.

Reserves should also be set up for the estimated amount owing to sundry creditors, and for traveling expenses of solicitors on the road. Too often, the bills which should have found expression on the books as audited vouchers unpaid, are allowed to burden the period following that of closing.

As the broker on the floor of the Exchange might have occasion to distribute some of his business to floor specialists, the commission payable thereon should not be overlooked.* The books should show very plainly whether any business has been so distributed, and if so shown, ample provision should be made in an account called "Floor Brokerage Commission Payable."

THE INCOME STATEMENT

1. Income from Operation

In a brokerage business the most important source of income is "commissions." The broker receives a commission for his services to customers, and he enters business with the purpose of earning such commission uppermost in his mind. Hence, this item will practically measure the amount of money which has been made in operating. An independent commission account might well be set up, if for no other reason than for statistical purposes.

All other items of income, as interest on customers' accounts, premiums, etc., are brought in under heading 5, "Secondary Income."

2. General and Administrative Expenses

This section should contain all expenses incident to the operation of the business, save solicitors' and branch office expenses.

*\$2 is the usual charge to a fellow broker for buying or selling 100 shares of stock of the par value of \$100, or \$10,000 of bonds.

3. Solicitors' and Branch Office Expenses

Solicitors' expenses, and those incidental to the conduct of branch offices, are usually kept under separate and distinct accounts for statistical purposes. The items usually included in these accounts are:

- Rent of branch office or offices
- Salaries of branch office managers and clerks
- Advertising of branch office
- Entertainment of branch office customers
- News ticker service
- Traveling expense of solicitors

The expense items under headings 2 and 3, represent all the expense usually incident to the general operation of the business, and they might properly be grouped under the one caption "Total Expense."

4. Net Income from Operation

This is the resultant figure arrived at by deducting "Total Expense" from "Income from Operation."

5. Secondary Income

Under this heading should be listed interest earned in financing customers' transactions. The usual items of secondary income are:

- Interest on customers' accounts
- Interest on notes receivable
- Interest on stocks borrowed
- Premiums on stocks loaned
- Interest earned on bonds held as investment
- Dividends on stocks held as investment

6. Deductions from Income

This heading embraces such items as:

Interest on stock loans equivalent to borrowed money

Interest on money borrowed

Interest on notes payable

Premiums on stocks borrowed are chargeable to the customer short of such stock.

7. Net Income from All Sources

The difference between "Secondary Income" and "Deductions from Income" gives the addition to, or deduction from, "Net Income from Operations," and gives the total net income from all sources.

8. Profit and Loss Charges

These charges should include a reserve provision for doubtful accounts receivable, wherever such accounts exist; a reserve provision for depreciation of furniture and fixtures (and in large banking offices this is an important item); a reserve provision for expenses in connection with the business in general; and provision for any loss incurred on the sale of securities which were held for investment.

9. Distribution of Profit

The distribution of any remaining profit would be a last factor in connection with the income statement.

THE BALANCE SHEET

Balance Sheet Items

The arrangement of the assets and liabilities on the balance sheet of a brokerage house does not differ from the arrangement usually employed by accountants. There are items, however, appearing in the broker's balance sheet which do not mean the same as they would on the ordinary balance sheet, but present apparent contradictions in

that they do not take into account the equity arising in customers' accounts or in collateral loans.

Assets

The asset side of the balance sheet is subdivided into:

1. Capital Assets
2. Current Assets
3. Deferred Debits to Income

Under the first heading, "Capital Assets," appear such items as exchange seats, investment in securities, and furniture and fixtures.

The second heading, "Current Assets," embraces cash, accounts receivable, notes receivable, stocks borrowed, and all accrued interest items. The accounts receivable recite no definite financial truth unless read in connection with the table of equities, a table showing the amount of margin which each customer maintains on his commitments (Form 24).

The third subdivision of assets, "Deferred Debits to Income," includes such items as rent paid in advance; advertising paid in advance; Stock Exchange dues paid in advance; and all similar items which have to be analyzed for the purpose of determining the portion applicable to the accounting period.

Liabilities

All liabilities are current in nature. There are no deferred credit items nor capital liabilities. Stock loans, accounts payable (which usually are deposit accounts or open credit accounts), interest accruals, and salaries accrued, all appear under the single caption, "Liabilities."

Proprietors' Accounts

The proprietorship section of the balance sheet, com-

prising reserves and partners' capital accounts, is self-explanatory.

Table of Equities

The table of equities (Form 24) sometimes referred to as the "Equity Statement," "Statement of Margins," or "Statement of Equities," is a most important supplement to the balance sheet. Its purpose is to present the status of each account into which might enter the consideration of margin in favor of, or against, the customer.

It will be recalled that some accounts operate under a credit arrangement. Suppose such an account is long of 5,000 Steel at 65, the purchase price, and that the present market price is 60. How does this affect the balance sheet? The ledger balance in this case shows approximately a debit of \$325,000, the securities appearing as 5,000 Steel. It is obvious that this does not reflect the true condition of the account, but as all the stock accounts receivable are grouped together in the balance sheet, it is practically impossible to segregate any particular account from the mass. From the broker's point of view, the statement of the account is correct, as the stock accounts receivable are considered absolutely good. But would the bank cashier who has occasion to review the balance sheet (that being the basis for future loaning operations), so consider them? Surely the facts are confusing—even misleading. But, as a corrective, the table of equities discloses the true condition of this and every other account carried on the books of the broker. On this the true condition of the account is shown, and the amount representing the accounts receivable is thereby modified by at least \$25,000.

The arrangement of the table of equities is such as to show, in each case, the name of the account receivable; the number of shares long and short; market price and

market value; the ledger balance, debit or credit; and the margin, debit or credit. If it be an open credit account, then the ledger credit and the margin credit would be the same. If it were an open debit, considered perfectly collectible, then the amount appearing in the ledger debit column would again appear in the margin debit column.

By this "refining" process, the accounts receivable, as represented on the balance sheet and as shown on the equity statement, are contrasted as to money values. This is done by footing the two margin columns, the difference between the debit and credit sides representing the equity due to customers or due the house from customers.

Every account is treated on this statement in such a way that the ledger columns really present the balance sheet accounts, while the equity columns reveal the balance and margins of each individual account as assets or liabilities.

Combination Equity Statement and Balance Sheet

Very often, instead of the standard form of balance sheet, a combination of the equity statement and balance sheet is employed. On such a combination statement, the facts and figures are thrown into contrast, and the result is a true presentment of the broker's affairs.

In the preparation of this combined sheet it may be said in brief that, as each balance is struck in the ledger, the amount of equity which the broker or the customer retains in the asset or liability is listed. For example, in his cash account, the broker would have 100% equity. In a stock account receivable, the customer's equity would be shown in his margin statement. The amount of margin which a broker retains in collateral loans is shown on the liability side of the balance sheet in the debit column.

CHAPTER XV

FAILURE AND DISSOLUTION

Voluntary Dissolution

Brokerage houses are usually partnerships, and their voluntary dissolution is easily accomplished by the mutual consent of the partners.

Under the law of partnership, dissolution may also be brought about by :

1. The expiration of the term as stated in the articles of copartnership.
2. The death of a partner.
3. The insanity of a partner.
4. The assignment of a partnership interest to third persons.

Very often the Street enters upon a period of depression, and usually before it ends, a number of brokerage firms tire of the inactivity it entails. Rents are high and other business expenses are heavy, and the losses are correspondingly large. Recourse is then had to voluntary dissolution. In that case the customers are notified of the firm's intention to discontinue, and a request is made for the settlement of all open accounts. This is made possible either by "taking up" the accounts or transferring them to some other broker. The assets remaining are distributed among the partners, and the business is dissolved.

Involuntary Dissolution

Involuntary or forced dissolution, on the other hand, is a more troublesome proposition. Sometimes, this condition is an outgrowth of untoward influences such as

panics or business depressions. In most instances, however, it arises through speculation on the part of the firm itself, which endangers its clients' funds by taking "fliers" in the market. If insolvency or bankruptcy does not result directly from such speculations, the Stock Exchange may intervene in the "private operations" of the firm, and expulsion or suspension result. What is more, the offenders are liable to their customers in actions for conversion.

When, in such a case, bankruptcy proceedings are instituted against the brokerage firm, several nice legal questions enter the case, the essence of which is the status of the customers as creditors of the firm, and the relation of other brokers to the bankrupt.

Release of Securities Held by Bankrupt

When a brokerage firm goes bankrupt, the most important question to be answered, and one which, no doubt, concerns the customer most, is how can he "lift" the account or, in other words, release the equity in his securities. There are several cases in law which cover this point.* In the matter of *Meadows, Williams & Co.*, 177 Fed. 1004, it was held that where the identical certificates of stocks or other evidences of ownership purchased in execution of a customer's order are traceable, he can, by payment of his debit balance, have his securities released to him. If, perchance, the securities have not been pledged, but are carried by the broker, the customer may succeed in his claim for the securities, although it is impossible to establish the identity of the certificates.

It was also held in this case that wherever the securities carried by the broker represent the holdings of several customers in the same stock—although the certificates be not possible of identification—each customer has a just

*See Douglas Campbell's "Law of Stock Brokers" for these and other cases in point.

claim to his pro rata share upon payment of an amount sufficient to release the securities. Also, if, at the time of failure, the broker has in his possession all the securities represented by customers' accounts, each customer may release his equity by paying the amount of his book balance to the assignee or trustee in bankruptcy.

In the case of *Chamberlain v. Greenleaf*, 4 Abb. N. C. 178, it was held that, if the securities be pledged to a third party to secure a loan to the bankrupt, and these securities be distinct and separate from all other securities, the customer may release his equity upon payment to the pledgee of the amount secured by such stock, and payment of any differences in the account to the legal representative of the bankrupt.

In the case of *Gould v. Central Trust Company*, 6 Abb. N. C. 381, it was held that when customers' securities have been mingled in one bulk and pledged, the customers can release their holdings by paying their pro rata shares so that the total will equal the amount covered by the pledge; and any differences are to be paid to the estate of the bankrupt. The court further ruled that, if a part of the securities shall have been sold in satisfaction of a prior lien of the pledgee, the balance of the securities may be disposed of, and the funds realized therefrom distributed on a pro rata basis among the various customers whose securities made up the loan, without the necessity of first determining which set of customers owned the securities which were sold in satisfaction of such lien.

Of course, the principles of equity as well as the doctrine of marshalling in the case of bankruptcy, would require that the broker's securities (which together with the customers' securities constitute the collateral in a loan) be first disposed of before any of the customers' shares be disposed of to satisfy a lien.

Customers' Equity in Deposited Securities

In the matter of Mills, 125 App. Div. 730; 193 N. Y. 626 (1908), a situation arose where a customer deposited with his broker securities as margin on a running account. These securities were pledged in order to raise funds, and subsequently it was contended that such stocks and bonds had no priority over securities that were purchased originally on margin. The court ruled that there was no distinction between securities deposited as margin and securities which found their way into a loan through purchase on margin.

It would appear, however, that if the securities were deposited for safe keeping and pledged without the knowledge or consent of the owner, such owner could insist upon the sale of securities bought on margin before any disposition could be made of his holdings. If it occurred that his securities were sold before the others, he could demand the disposition of the remaining securities in order that restitution be made to him to cover the fair value of his stocks or bonds.

If it be evidenced that collusion existed between the pledger and the pledgee, and because of this the securities owned by an innocent third party were disposed of to satisfy a lien, then such innocent third person would be supported in his claim to recover full value.

Equity in Clearance Loans

In the case of the Mechanics' National Bank *v.* Ernst, it was decided by the United States Supreme Court November 3, 1913, that clearance loans carried with them no superior equities in securities which such loans helped to procure. It was ruled that the bank was only a general creditor and was entitled to share as such.

Generally speaking, the National Bankruptcy Act gov-

erns almost exclusively all actions for the recovery of securities when the broker has been adjudicated a bankrupt.

Disposal of Broker's Stock Exchange Seat

In regard to the bankrupt broker's membership on the Exchange, Sections 1 and 3 of Article XVI of the constitution of the New York Stock Exchange, provide as follows:

"A member who fails to comply with his contracts or is insolvent, or who is a partner in a firm registered upon the Exchange which fails to comply with its contracts or is insolvent, shall immediately notify the President, in writing, that he or his firm is unable to meet their engagements, or prompt notice thereof shall be given to the Exchange. He shall thereby become suspended from membership until, after having settled with his creditors or the creditors of his firm, he has been reinstated by the Committee on Admissions. If a member suspended under this article fails to settle with his creditors and apply for reinstatement within one year from the time of his suspension, his membership shall be disposed of by the Committee on Admissions."

Before the customers may share in the funds realized from the sale of the Exchange seat, all the claims of members of the Exchange shall have first been paid. Any surplus remaining thereafter is distributable among the respective creditors of the firm and of the partners individually.

In summing up it may be said that there are many other features and conditions of the broker's bankruptcy which are too technical for discussion here. Only a few cases have been cited as illustrative of the more important phases of the question and as indicating the status of customers in the capacity of creditors. Almost daily, prob-

lems are met in which a knowledge of the law is invaluable to the accountant whose duty it is to ascertain the equities of customers of a defunct brokerage concern, and for such accountants a fair knowledge of the law and procedure in such cases is essential.

Part II—Cotton Brokerage

CHAPTER XVI

THE COTTON FUTURES MARKET

The Market

The cotton futures market plays an important rôle in the disposition of the annual cotton crop. It is the medium for distributing approximately 15,000,000 bales yearly, which, resolved into terms of money, gives \$1,050,000,000, figuring the average price of cotton at 14 cents per pound. The system of "Futures" facilitates the movement of cotton from planter to spinner and thence to consumer.

Cotton brokers are engaged in trading for either "spot" delivery or "future" delivery. The former involves but very little accounting, and is treated in Chapter XXV. The accounting requirements of the futures market are, on the other hand, peculiar, and the mechanism of its accounts and the relations between them are intricate.

Expressed briefly, the futures market is a system of trading in cotton options, the commodity itself being either potentially or actually existent, but not deliverable until the time specified in the contract. The active issues or options traded in are those of January, March, May, July, August, October, and December. An option for any of these months may be traded in up to the last "tender day" of the preceding month, this last tender day being the time set by the Cotton Exchange for the expiration of the options for a certain month and the ceasing of trading in such commitments. For example, January, 1916 cotton may be

bought or sold up to the last tender day in December, 1915; or May, 1916 cotton may be traded in up to the last tender day in April, 1916.

If January, 1916 cotton is purchased, the commodity would be tendered on or about December 31, 1915, and the purchaser would be called upon at that time to make payment against the delivery to him of a warehouse receipt. On the other hand, if the buyer wishes to dispose of his holdings of January cotton, he might do so at any time before the last tender day.

Most of the buying and selling of cotton futures is for speculative purposes, i.e., the customer does not wish to buy cotton and has none to sell. In such case, when his commitment falls due, settlement must be made in some other way than by the actual receipt or delivery of cotton, and this must be done on or before the last tender day.

A customer having a long interest in the market will usually sell his cotton for the outgoing month, and if he wishes to retain his long interest, will purchase in lieu thereof futures for some other months. For example, assume that John Doe is long of March. Being compelled to sell out his "longs," he sells March cotton, thereby satisfying his March contract; and, wishing to retain his long interest in the market, buys May. Or suppose that John Brown is short of March. Being compelled to buy in by reason of the approaching expiration, he buys March and sells May, thereby retaining his short interest. In these cases it is taken for granted that Brown did not intend delivering his March contracts, and that Doe did not contemplate the actual receipt of his March commitments; and not intending to deliver or receive the cotton, it becomes compulsory for them to settle the contract by sale or purchase of the maturing options.

Mills which sell a good deal of their output on contract

at a certain price, use the futures market for hedging purposes. If the price of raw cotton rises after a mill sells its product and before the goods are manufactured, the mill will lose the difference between the increased price and the price of raw cotton at the time it entered into the contract of sale. To prevent such losses on advance sales, the mills, as stated, will usually hedge by purchasing a sufficient number of bales of futures to protect themselves against any increase in the price of the raw material. When this is done, if the price of cotton rises, the loss incurred by the increased price of the raw material is offset by the profit reflected in the cotton bought on futures. If, on the other hand, cotton falls, the additional profit this gives them on the manufactured product offsets the loss on the futures. Thus the "futures" purchase serves the purpose of a stabilizer or insurance against loss. Spot cotton dealers use the futures market much in the same manner.

An additional function which the futures market performs is the maintenance of a ready market for cotton, having as a measure for its prices the effective demand for, and the real supply of, "classified raw" cotton. It eliminates the very wide and arbitrary fluctuations of prices that would otherwise occur.

Customs of the Futures Market

According to the rules set down by the New York Cotton Exchange, cotton is traded in for future delivery in quantities of not less than 100 bales, each 100 bales; in technical terms, constituting "one contract." On this basis 1,000 bales of cotton are equivalent to 10 contracts. Furthermore, the Exchange has specified the weight per bale as 500 pounds. Therefore, one contract, or 100 bales, is of the approximate weight of 50,000 pounds. The price of cotton is quoted in terms of cents and hundredths of a

cent per pound. One cent on 100 bales is equivalent to \$500. One one-hundredth of a cent on the contract equals \$5. A fluctuation of $1/100$ of a cent is known as a point, so that a point is equivalent to \$5 per contract.

The only cash transactions in the futures market are those in spot cotton. All other transactions are settled by means of the "differences" system which has as its chief features a cash payment, or receipt, for the difference between the price paid for the cotton and the price which it yields upon sale. Thus, if a customer purchases 100 bales of cotton at 13.08 cents per pound, and sells it at 13.20 cents per pound, he will gain the difference of 12 points, or \$60, as a result of the deal. Figuring this by the ordinary method of calculating, the contract of 50,000 pounds at 13.08 cents per pound would cost \$6,540. At 13.20 cents it would yield \$6,600, or a profit difference of \$60.

Books of Account

Two distinct sets of books are kept by the cotton broker, the one dealing with the transactions of the customers and the other with the same transactions from the Street end, i.e., the dealings between brokers. Only by a system of interlocking between the two sets of books is a check upon the Street books made possible. Reference to this point will be made later (Chapter XXI).

The Customers' Records

The books used for the record of transactions with customers are as follows:

- Purchases and Sales Book
- Customers Margin Book
- Customers Contract Book
- Customers Ledger

General Journal

General Ledger

Cash Book

Account Sales Register, or Contract Analysis Journal

The Street Records

The transactions between brokers are a reflection of their customers' dealings, and the purchases and sales book is the basis for transferring the contracts traded in to the Street records. Nothing should appear in any of the Street books which cannot be traced either to the purchases and sales book or to the Street blotter. The purchases and sales book therefore enters into both the customers' and the Street records. The complete set of Street records is as follows :

Purchases and Sales Book

Street Blotter

Street Ledger

Street Margin Ledger

Street Settlement Book, or Brokers' Statement

CHAPTER XVII

CUSTOMERS' RECORDS

Purchases and Sales Book

The ruling and arrangement of this record (Form 25), does not vary in any material way from the similar book used in the stock brokerage business. The headings of the columns are practically the same, though the caption of the column on either side of the book changes from "Number of Shares" to "Bales."

Customers Margin Book

The principles underlying the system of margins in the cotton market are the same as in the stock market, so that the same card system or loose-leaf device can be installed with good results. Form 26 shows a typical loose-leaf margin sheet employed by cotton brokers. Custom has dictated 40 points, or \$200, as a safe margin on one contract, and conservative brokerage concerns call for additional margin when, at the market price, one-half of the existing margin is consumed by paper losses. For instance, if the customer, John Brown, purchased 100 January at 13.08, 4 points for commission are immediately added, making the price to him 13.12. If the price of January declines 11 points, or \$55, this potential or paper loss is subtracted from the margin which Brown deposited on account of his purchase. Assuming, then, that Brown had originally a ledger credit of \$200, the remainder of his margin is \$145, or 29 points, and is still sufficient to carry the account. If, however, the price for January declined to 12.92, Brown would be called on for \$100 additional

margin. If he failed to respond after a reasonable time (depending altogether upon the condition of the market to gauge the expression "reasonable"), an order would be entered to sell 100 January at 12.72 on "stop," this meaning that when the price of January fell to 12.72, the order would be executed at that price for the option. Having purchased the contract at 13.12 (including commission), and sold it at 12.72, Brown's loss thereon would be 40 points, or \$200.

It should be noted here that an entire contract comprises both the purchase and sale of a commitment, and that the commission of \$20 covers both purchase and sale or delivery.

Customers Contract Book

Form 27 shows a sheet from the customers contract book. This book is entered from the purchases and sales book. Each customer has one page allotted to him, and the ruling provides for the classification of the options bought and sold, the date of each transaction, and the prices paid and received. There is also a column providing for the insertion of an "Account Sales" number. Each contract is entered on a separate line. Thus, the record of 10 contracts purchased is expressed by 10 separate entries, even though the entire purchase was made at one time. This is done to obviate any error in closing or setting off such purchases, and to make possible the recording of account sales numbers. These account sales may be rendered at ten different times, depending upon the manner in which the purchases are disposed of, or the short sales covered. They may be closed all at once or at intervals of days.

All transactions are classified according to the options involved. Thus, any dealings in the option, May, 1915,

would be classified in the column headed May, 1915. Similarly, all purchases or sales of other months would be classified in their respective columns.

A loose-leaf device gives the best service in this particular book. Since it is tabbed alphabetically, the customers' accounts can also be arranged in that manner. Furthermore, the book can be expanded or contracted—a most convenient and desirable feature in this line of business, since “dead” accounts can be removed to the transfer binder, while the active accounts are allowed to remain.

As will be noted (Form 27), no monetary column appears other than that for entering the price per pound. As may be inferred from this, the customers' accounts in the ledger are not charged with the cost of purchases nor with the proceeds of sales, but, as will be seen later, reflect only the profit or loss difference. For example, if John Jones purchased 100 January at 13.08 and sold 100 at 13.20, his account would not be charged with \$6,540 nor credited with \$6,600, but is credited with his profit of \$60. Therefore, this customers contract record contains only the options of customers, having no regard for the money values involved beyond the mere record of the price per pound.

This characteristic of the cotton futures business emphasizes the “difference” method employed in charging or crediting accounts by reason of purchase or sale of futures. All the commodity futures markets are operated in the same manner, i.e., through the “differences” method outlined above. The system is employed because it is convenient, accurate, and wholly in line with the custom of the business.

Opposed to this method of accounting, is that of charging the customer with the amount of his purchase, and crediting simultaneously the Contract Differences account. This is correct in principle, perhaps even more so than the

method in vogue, for the reason that it shows the actual debt by the customer who, it is always supposed, will pay for his contract at the time of delivery. By crediting the Contract Differences account, the liability with the Street is set up, and at delivery time is discharged by payment. The same result is accomplished as in the first case, with the additional advantage that the contracts or options find expression in a financial way. The first method, however, is supported by the two very logical reasons stated in the following paragraphs:

1. The contract is purely an option for the receipt or delivery of a specified month's cotton. This cotton may or may not be received or delivered by the contracting parties. In view of the doubt which exists on the part of the customer as to his intention of effecting receipt or delivery, no charge should be set up against him. If eventually he means to avail himself of the option he holds, and expresses this intention, then it would seem that a charge for the purchase and a corresponding liability to the Street would be warranted.

2. In case of a sale, the planter or the speculator making commitments may not intend to make delivery against the sale. It might be that the sale was made for hedging purposes or as a short "flier" in the market. Or the purchaser, say a spot man, may have entered the futures market merely to avoid any possible loss from a rise in the price of spot cotton after contractual relations have been entered into between the spot man and the mill. If the credit to the customer and a corresponding charge in the Street records were set up, it would reflect entries which at best would express but contingencies.

For such reasons, it is obvious that nothing is lost or misstated by treating option transactions by the first method of accounting.

Customers Ledger

The customers ledger is an underlying ledger, and does not vary in principle from the ordinary customers or creditors ledger. Hence it does not require further comment. The "Boston" or three-money-column ledger is used. (See Form 28.)

General Journal

For the purposes of cotton brokerage, the general journal remains unchanged as to the uses to which it is put. However, as seen in Form 29, two frequently recurring items will be found therein. One is "Cash in Sundry Banks" charged with deposits, wired by other banks as margin from customers out of town. The other item is the credit entry, in the Customers' Controlling account, specifying which individual account is to be credited. As an example, Frederick Jones of Sumter, South Carolina, deposits for the credit of his broker in New York, \$500. Upon receipt of the bank advice, the broker debits Cash in Sundry Banks with \$500, and credits the Customers' Controlling account with a similar amount.

General Ledger

The general ledger contains all real and economic accounts, including, of course, the controlling accounts for customers' and Street margins. A bound book better answers the purposes of this ledger.

Cash Book

The cash book, as shown by Forms 30a and 30b, has special columns conforming to the needs of the cotton brokerage business. On the cash receipts side of the book are found columns for net cash, exchange and collection, contract differences, Street margins, interest on margins,

customers' controlling account, and a general ledger column. On the cash disbursements side the columnarization provides for the same factors with the exception that there is no column for exchange and collection or for interest on Street margins. In addition, there are general and sundry expenses columns.

Balancing the Cash Book

The cash book is balanced monthly. The various columns are footed and posted to the respective ledger accounts as follows:

On the cash receipts side, the total appearing in the customers column is posted to the controlling account in the general ledger, it being assumed that the cash payments by customers have been credited daily in the underlying ledger. The total of the "Contract Differences" column represents cash received through the clearing house as settlements by other brokers, and hence is credited to the Contract Differences account. The "Street Margins" column is posted in bulk to the Street margins controlling account in the general ledger, it being again assumed that the respective credits, representing released margins, have been posted to the underlying Street margin ledger (Form 31) in the regular course of the month. "Interest on Margins" represents an earning, since that interest is earned on margins which were released. The total of this column is posted to an account in the general ledger called "Interest on Margins." The accounts appearing in the "General Ledger" column have already been posted, making further comment unnecessary.

The disbursements side of the cash book is treated in a similar manner, paying due regard to the posting of the totals in the respective columns. The Cash account in the general ledger is charged with the receipts and credited

with the disbursements for the month. Finally, the balance appearing in the cash book is carried down and the operations for the next month are continued as before.

The difference between the amount paid out to the Clearing House and the amount received therefrom, as shown by the "Contract Differences" column, should be reconcilable to the net sum paid or received, as shown by the brokers' statement or settlement book (see Chapter XX), in which recapitulation of payments and receipts is made at the end of each month.

CHAPTER XVIII

CUSTOMERS' RECORDS—THE ACCOUNT SALES REGISTER

The Contract Differences Account

The account sales register or analysis journal (Form 37) is a journal in both form and principle. It records financial facts, reflecting losses or gains in the respective customers' accounts. When the customer incurs a loss, the broker, who is acting as an agent for his principal, will be called upon to settle for it eventually. At this point one fact is certain—the customer must be charged with the loss incurred and also with the commission on the transaction as a whole. It is also certain that an account payable with the Street has been created. This liability account receives the technical designation of "Contract Differences."

If a gain is to be journalized, the customer must receive credit for his net profit, the Commission account also receiving credit for the amount due. Also, in the case of a profit, an account receivable is created, for surely this profit difference will be received from the Street either directly or indirectly; at least, it can be said that the asset account is evident. The same technical designation, "Contract Differences," is given to the asset account.

The Street custom has possibly adopted a wrong principle in accounting in merging accounts receivable with accounts payable, reflecting as a resultant a balance figure which is sadly in need of analysis. Examining more deeply into this matter, however, it will be found that the

violation is less to be condemned when we consider the system under which the Street end of this business is conducted. What may be an account receivable, considering the option months separately in the customers' division, might result in an accounts payable to the Street. The identity of the customers and their individual profits and losses are lost in the Street books.

Factors Affecting the Contract Differences Account

Without entering into the question of settlement between brokers, it may be stated here that two factors of settlement in the Street have direct bearing upon the Contract Differences account. One is a receipt of cash from brokers through the Clearing House; the other, payments to the Clearing House for the accounts of brokers. The former indicates that the broker has a claim on the Clearing House by reason of profits in the process of collection. The latter carries with it the implication that losses of the customers are being liquidated through the machinery of the Clearing House. Also, the Contract Differences account is charged or credited with the respective profits or losses incurred or realized on customers' transactions.

Four factors then enter into the Contract Differences account: (1) charges as offset entries to customers' profits; (2) losses of customers indicated by a credit to the Contract Differences account; (3) receipts from brokers through the Clearing House, attesting to payment on account of customers' profits; (4) payments to the Street against losses on customers' contracts.

The purpose of conducting a set of Street records is to make possible the immediate liquidation against closed or completed contracts. In view of this, no case could be conceived of where the contracts with the Street would

be settled in the same order as are the contracts of customers. Take as illustrations a purchase of 100 January at 12.10 for the account of John Brown, and a subsequent sale at 12.40 for the same account; also a purchase of 100 March at 12.00 and a subsequent sale at 11.96 for the account of L. Smith. Assume, for convenience, that all these transactions were made with Hamlin & Co. In the first case, the Contract Differences account would be credited with \$150, representing 30 points profit on the January trade. On the March transactions 4 points, or \$20, would be lost. The Contract Differences account would show a debit balance of \$130, being composed of an account receivable and an account payable. The operations of the Street books contemplate, at best, the receipt of \$130, regardless of the broker from whom receivable, or of the customers with whom profits and losses are settled. This emphasizes the statement that no cognizance is given to the customers' losses or gains as soon as the transactions reach the point of entry in the records of the Street.

Arrangement and Operation of Account Sales Register

The account sales register or analysis journal is entered from an account sales rendered to the customer, which in turn is made up from the customers contract book.

The columnar arrangement of this journal, as shown by Form 37, is as follows: the account sales number; the date; customer's name; folio; number of bales, and option months covered by the account sale; a debit and a credit column for entering losses or gains (always including the commissions) of the customer; a debit and a credit column under the caption "Contract Differences," where, in the case of a debit or a credit to the customer, a corresponding credit or debit, less the commission, will be

found. Finally, there is a column for the commission alone.

The following illustrations will serve to show the working of this journal. Taking the transactions of John Brown who purchased 100 January at 13.08 and sold at 13.20, the following entry would appear:

Debit Contract Differences.....	\$60.00
Credit John Brown.....	40.00
Credit Commission.....	20.00

Taking the case of a loss of \$60 by John Jones, the entry would be:

Debit John Jones.....	\$80.00
Credit Contract Differences.....	60.00
Credit Commission.....	20.00

If a customer bought 100 January at 13.04 and sold at 13.08, the entry would be expressed:

Debit Contract Differences.....	\$20.00
Credit Commission.....	20.00

In this case no entry whatever would be made in the customer's columns, as the trade, so far as he is concerned, reflects an even settlement.

Or assuming a purchase of 100 January to have been made at 13.05 and to have been sold at 13.05 for the same customer, the entry would appear as follows:

Debit Customer.....	\$20.00
Credit Commission.....	20.00

No entry would be made in the "Contract Differences" columns for the reason that no accounts receivable or payable are created with the Street, since the transaction from the Street end is a flat or even settlement.

The contract analysis journal is of the type of a special journal, or a complex-type book of original entry. Being columnarized, it presents the possibility of allowing controlling accounts in the general ledger, and this is the case in actual practice. The debit and credit items resulting from either losses or gains of the customers, are posted daily to the respective customers' accounts in the underlying customers ledger. At the end of the period, which is most frequently the end of each month, a recapitulation of the debits and credits is made, and this summary is posted to the respective accounts affected, including the posting to the Customers' Controlling account.

To illustrate this point, let it be assumed that the total debits in the customers debit column is \$18,000; that the total credits in the customers credit column is \$25,000; or a net difference between the two columns of \$7,000 credit. If the total in the contract differences debit is \$26,000 and the total of the credits is \$18,000, or a net difference of \$8,000, the "Commission" column must total up to a credit of \$1,000. To recapitulate, therefore, the following summary would appear:

<i>Debit</i>		<i>Credit</i>	
Contract Differences....	\$8,000.00	Customers	\$7,000.00
		Commissions	1,000.00
	<u>\$8,000.00</u>		<u>\$8,000.00</u>

The Contract Differences account would be charged in the general ledger with \$8,000, the Customers' Controlling account credited with \$7,000, and the Commission account credited with \$1,000.

The recapitulation of the account sales register, or

analysis journal, is necessary before a trial balance of the general ledger can be taken.

Customers' Accounts Payable

In the ordinary sense, a customer is looked upon as one who purchases, and, on account of the purchase, is charged. When he pays, the account is credited and balanced. Vice versa, a creditor is looked upon as a person from whom goods are purchased or who has yielded any other benefit. But, in the brokerage business something different arises. The customer deposits margin for which his account receives credit. As no other offsetting entry appears, the account becomes an account payable or creditor's account. Any losses which might be subsequently charged to the account, still keep it as a creditor's account, for only infrequently is a debit balance account allowed to remain on the books. Thus an invariable rule is dictated, that the only accounts kept with customers or clients are accounts payable. For the foregoing reason, no other controlling account with customers would be kept than accounts payable. A practice of charging all debit accounts to profit and loss prevents the possibility of any accounts receivable appearing beyond a reasonable length of time. In auditing accounts this rule should be remembered.

Customers' Statements

Unlike the stock business, in the cotton brokerage business, no interest is charged or allowed on customers' balances. Each customer receives a monthly statement of his account, showing the profits and losses arising out of his transactions during the month. When the account in the customers ledger is balanced, a statement is rendered to the customer, similar to that shown in Form 33.

Statement of Open Trades

Besides receiving a statement of settled transactions, each customer receives a statement of open or unliquidated trades, similar to that shown in Form 34. This statement is made out in duplicate, thus furnishing a basis for the compilation of the "Point Balance," which is explained in Chapter XXI.

Account Sales Statement

Form 35 shows the account sales statement which is sent to each customer as soon as a transaction is closed by either purchase or sale against open commitments, and gives the customer's loss or gain. It will be observed that the transactions are not carried out into dollars, but that only the difference in points is considered. The gross profit or loss is the same as the amount treated in the Contract Differences account through the medium of the analysis journal.

CHAPTER XIX

THE STREET RECORDS

Purchases and Sales Book

The purchases and sales book (Form 25) appears among both the customers' and the Street records. While its most important feature is the record of purchases or sales for the customer, and this information is the basis of entry for the customers' records, the same purchases and sales book also supplies information for Street purposes. In the Street division the names of contracting brokers and the number of bales contracted for are the essentials; the customers' identity is wholly lost.

Cotton Contract Blotter

The "Street Blotter," or "Cotton Contract Blotter" (Forms 36a and 36b), is written up from the purchases and sales book. Its arrangement is such that each current option month is allotted a separate section. There are commonly found eight sections providing for the following options: January, March, May, July, August, October, December, and sundry months. Each "contract" is entered separately and the purchase of 1,000 bales, whether signed up or contracted with one or ten brokerage houses, necessitates ten separate entries.

Unlike the blotter used in the stock brokerage business, the book as used here is not a financial record. Its purpose is to gather information for the further posting of the Street ledger, and the eventual settlement of accounts among the brokers concerned in any given transaction. The "sign-up slips" or forms of contract, bearing the

names of the contracting parties, are used for the purpose of making the blotter record complete. Thus, the ruling of the book must allow for the following information: the number of bales listed in single hundreds; the contracting broker's name; the price at which purchased or sold; and the name of the customer so purchasing or selling.

Street Ledger

Strange to say, while the Street ledger (Form 32) is a book of secondary or summary entry, it is not, strictly speaking, a financial record. While it shows the settlements on various contracts, this information being of a financial nature, the results of the settlements cannot be classified or collated for either trial balance purposes or for any other financial information.

The Street ledger is so arranged that the contracts are classified under sections, one section being devoted to each contracting broker. Each section is further divided into current option months, one page being allotted to each month. The brokerage houses are alphabetically arranged and tabulated so that each individual account stands out conspicuously. If occasion arises to turn to an account, it can be done with the least amount of effort, and, direct from that section, any information regarding the particular account is readily available.

Arrangement of Street Ledger

Being posted from the blotter, this ledger contains all the facts relating to the Street end of transactions. Thus, for example, the account of B & Co. on the page recording January options (Form 32) contains the following facts: To the extreme left of the page is given the actual date of purchase. As each contract of 100 bales

is written up separately, one line represents one contract, or 100 bales. The second column provides for the price; while the third column, which is used for remarks, is not filled in until later. Following this is a double rule which separates the purchase side of the record from the sales side. This second division of the ledger contains columns for the date of sale, price, and remarks. The folio shows the purchases of customers of the concern keeping the books, and not, as might be imagined, purchases for the account of the contracting broker whose name appears at the head of the section. To illustrate this point, any contracts in B & Co.'s account on the purchase side of A & Co.'s Street ledger, would mean that B & Co. had sold the stated number of bales to a customer of A & Co., and a corresponding construction is to be given to the sales division of the Street ledger folio.

As settlements are inevitable, suitable provision must be made somewhere in the arrangement of the Street ledger for a record of such payments or receipts. Hence, if by chance, or by expiration of the contract, an offset with B & Co. should be made, it would result either in a payment to, or a receipt from B & Co. To accomplish this end, the Street ledger shown in Form 32 contains two monetary columns to the extreme right, one for payments to B & Co. which would be reflected in the debit column, and the other for receipts from B & Co. which would find expression in the credit column. In the case of a credit it would mean that money had been received on the closed trade from the individual broker; in the case of a debit, that money had been paid to him. As an example, if A & Co. purchases from B & Co. 100 January at 12.00, and the settlement or sale price was 12.50, it follows that B & Co. would owe A & Co. 50 points, or \$250 (see Form 32).

The Street Margin Book

The fourth book of the Street records is the Street margin ledger (Forms 38a and 38b). The name of this book is indicative of its contents. It is a record from which the condition of margins between brokers can be read. In principle it is similar to the customers' margin system. The only difference which exists between the two is to be found in the purposes for which such memoranda are kept.

The by-laws of the Cotton Exchange contain certain regulations relating to margins between brokers. The reason for such regulations is traceable to the fact that a contractual relationship exists between the brokers concerned from the time that a contract for futures is entered into until such contract is terminated. More explicitly, the relation of the broker to his customer is extended to a third party—the other broker—thereby imposing the same duties upon the brokers involved in the transaction as devolve upon such brokers by reason of their relation to their customers.

Unlike the stock business, a contract arising out of the sale or purchase of cotton is not consummated upon the next business day. With stock transactions, the third party broker has no further right or duties beyond the point of delivering or receiving stock against payment. On the other hand, a cotton contract might be made which could extend over a period of almost a year. For instance, a purchase made in February of the present year, of 100 bales of next year's January cotton, might be carried along until December 31 of the present year. It is obvious, then, that a very wide difference in price might be reflected between the date of purchase and the date upon which the contract is finally closed.

To illustrate, let it be assumed that the customer pur-

chasing the 100 bales of January, holds the contract up to the very last tender day. It is apparent that he must keep his contract well margined. The same demand is made of the brokers in order that the open contracts be kept at market prices until they are closed. This shows the threefold character of an open transaction.

Ruling and Arrangement of the Street Margin Book

Forms 38a and 38b show respectively a left-hand and a right-hand page of a typical Street margin book. Two facing pages are allotted to each broker with whom contracts have been made. The left-hand or "long" page is divided into eight main sections, each headed by a caption indicating an option month. All purchases made from the broker whose name appears at the head of the page are represented on this left-hand page. The respective month columns are subdivided to show the date of purchase, number of bales, and the cost price. At the top of the page, space is left for "Margin up by them." On the right-hand or "short" page, a similar ruling is to be found. The captions are the same with the exception that the space at the top for margin information is headed "Margin up by us."

Relation between Margin Book and Street Ledger

As purchases and sales are made from day to day in the Street ledger, the entries are duplicated in the Street margin book. Thus, all facts, save those which are expressed in the monetary columns of the Street ledger, are transferred to the margin book. If a contract be settled, a line is drawn through that particular entry in the Street margin book. At all times, then, if comparison be made of the open contracts with the Street, the information which is furnished by the Street ledger should be pos-

sible of reconciliation with its companion record—the Street margin ledger.

As an illustration, let us consider the following transactions: On February 5, 500 bales of March were sold by broker A to broker B. Without regard to the other Street books, the record of sale would be found in A's Street ledger. The same transaction would also be found in A's margin book on the right-hand page allotted to B. If, by a subsequent purchase of 300 March, a direct settlement with B were effected, the Street ledger would attest to the settlement by showing only 200 March open. Simultaneously, B's account in A's margin book would be made to show the same number of contracts open. Needless to say, the price of such open contracts as shown by these two records would be similar.

Margin Call and Release

It is imperative that a constant review of the contents of the Street margin book be made with the purpose of either calling on brokers for market margin due, or of releasing such margin deposits as are free and clear. To illustrate the operation of the margin call, suppose that, on February 15, broker A purchased for the account of his customer from broker B, 100 January at 12.90. On March 6 the market price rose to 14.00. In that case B would owe A the difference of 110 points, or \$550. Purchasing broker A would then send a "market margin call" (Form 39) to B, who upon receipt thereof would respond (Form 40) by depositing with the Superintendent of the New York Cotton Exchange an amount of money sufficient to bring the contract with A up to the new market price. Conversely, if the price should operate against the purchaser and fall below 12.90, then B would have the right to demand market margin from A.

When margin has been deposited and the changing market price nears a point where the difference between the contract price and the market price is very small, or where the two prices approximate each other, the party who deposited the margin is entitled to its release. Thus in the foregoing example, if after B deposits margin in response to A's call, the price of January again drops to 12.90, B's contracts at this price reflect no market loss. Hence, the margin which he put up, which is on deposit with a trust company, is releasable. Upon demand, broker A then indorses the margin certificate held by B, who thus obtains a release of his money.

The margin certificate referred to is an instrument issued by virtue of the Exchange, as evidence that money has been deposited in response to a margin call. The certificate may be made payable to either broker, as the Superintendent of the Exchange may direct. In the foregoing illustration, the certificate would be issued to B when he deposits margin in response to A's call. If thereafter the market price for January goes back to 12.90, B no longer owes A any money on open contracts, and he is required to release by indorsement of the margin certificate B's funds tied up in margins. The Superintendent of the Exchange also attests to this release by indorsing his name on the back of the certificate. (See Form 41b.) Thus the margin certificate becomes a negotiable instrument, which may be deposited by B for its face value.

Interest on Margins

Another phase of the system of margin deposits is the interest allowed by the trust company with which the funds are deposited. In drawing his check, B makes it payable to some bank designated by the Cotton Exchange

as a depository for margins. This check is certified, and to it is attached a notice to A (Form 40), stating that in response to the margin call a stated sum has been deposited by B in some specified bank or trust company. When the Superintendent of the Exchange receives both the check and the notice, he stamps "Paid" on the face of the latter and causes it to be delivered to A, as his notice of B's response and deposit. Interest on margins at the rate of 2% to 3 1/2% is allowed by the bank or trust company, so that if a margin of \$2,000 were released after 35 days' time, the interest would, assuming the interest rate to have been 3%, amount to \$5.84; and this interest would be paid with the principal.

Original Margins

A word may be added here in reference to another form of margin. Brokers doing a customers' commission business may be divided into two classes. The first embraces the strong financial houses; the second the medium and weaker houses. In no other line, perhaps, does credit play such an important part in the relationship between contracting parties.

The Exchange has designated certain rules and regulations in regard to market margins, as already explained. The by-laws of the Exchange also provide for what are called "Original Margins." A broker, who has reason to believe that a party with whom he has contracted belongs to the second class, may send a margin call demanding an original margin of \$200 to \$500 for each contract. These originals are also frequently demanded from the larger houses with whom many contracts have been made. In any event, all calls for original margin must be made within 24 hours after the contract has been entered into. The broker "called" for margin of \$5 a bale or \$500 on a

contract, must deposit that sum with the Superintendent of the Exchange; and this should be done as soon as the call is received.

Time for Deposit of Market Margins

All calls received before 10:30 A.M. on days excepting Saturday must be deposited before 11:30 o'clock of the same day. Calls which are received after 10:30 A.M., and before 12 o'clock, must be deposited before 2 P.M. of the same day. Calls coming in after 12 o'clock must be deposited before 11:30 A.M. the next business day—Saturday excepted. Calls received after 12 o'clock on Friday must be deposited before 11 A.M. on Saturday. Calls received on Saturday before 10:30 must be deposited before 11 A.M.; those received after 10:30 must be deposited before 11:30 A.M. the following Monday.

CHAPTER XX

SETTLEMENTS BETWEEN BROKERS

Conditions Affecting Settlements

In all futures business, contracts may be sold short and eventually covered, or they may be sold for actual delivery. In the latter case the producer might ship his cotton to New York for delivery against his sale. On the other hand, cotton may be purchased with the purpose of making profit on an advancing market, or it may be purchased with the actual intention of receiving the commodity. Such a state of affairs permits of short selling or long buying. This condition might be further reflected by a sale being posted in the contract ledger with no offset on the purchase side. A similar condition arises again in the case of "long" cotton being sold to a broker with whom no "long" contracts were held.

As an example, suppose A & Co. buy 100 bales of January from B & Co. for the account of Jones. When Jones gives his selling order, 100 bales of January might be sold to C & Co. This illustrates two points :

First, that open contracts can exist with the Street brokers without having a corresponding interest in the market for the account of customers, though the net interest, or the result after considering all the contracts, must, of course, be similar to the result obtained after treating the customers' holdings. In the case cited, A & Co. had no interest in the market for the account of the customer ; yet the Street ledger reflects a condition totally different from the one mentioned. But if the net difference of the contracts, long and short, were taken into account, the Street ledger would also reflect such interest in the market.

Second, that the Street books are kept in total disregard of the customers' division; that is, so far as the memorandum facts are concerned. A reconciliation with the customers' books is not even attempted, and under the system employed it could not be successfully made. Only after careful compilation and an understanding of the construction of the accounts, can proof be had attesting the correctness of the Street books.

From this it may be seen that settlements with the individual brokers cannot be expected at the same time that settlements with customers are made.

Methods of Settlement

Generally speaking, there are four methods employed for settling outstanding Street contracts between brokers. These are:

1. Direct settlement
2. Ringing method
3. Street let-out
4. Tender of notice

1. Direct Settlement

The method of settling contracts between brokers by way of direct payment or an offset by either purchase or sale, is so obvious as to require no discussion. But, suppose that a broker purchases options from sundry brokers, and sells them at some subsequent time. In order to liquidate the outstanding Street contracts, one of the three methods, other than direct settlement, may then be employed.

2. Ringing Method

The first indirect method of settling contracts in the Street is by "ringing." By this is meant the matching of names of buyers against sellers of the same options, with

the purpose of literally "getting out" of the contract and thus effecting a settlement. The term "pair-off" aptly describes the ringing method—a system of settlement encouraged by the authorities on the Exchange, for it greatly relieves the burden on the last day of tender, or, as it is commonly called, "Notice Day" or "Transfer Day."

To illustrate the ringing method of settlement, assume that broker A sold to broker B 500 bales of May, and purchased from broker C the same quantity (price does not enter into the ringing method nor into any other indirect method of settlement among brokers). If B should sell to C 500 bales of May, A could "ring" these contracts and the result would be a transfer to C of A's contracts with B. B could also settle his contracts with A and C, and C could settle with B and A, and in this manner an offset could be had and a settlement of all the transactions effected.

To make this clear, let the Street ledgers of A, B, and C be taken, in which appear these hypothetical purchases and sales.

A. Street ledger shows a sale to B of 500 May, and a purchase of 500 May from C.

B. Street ledger reflects a purchase from A of 500 May, and a sale to C of 500 May.

C. Street ledger reflects a purchase from B of 500 May, and a sale to A of the same quantity.

Hence the following offsets would be made in the three books:

A, in offsetting the account of B, would do so by entering 500 May on the left-hand side of the folio, and placing the name of C in the "Remarks" column. This will constitute a cross-reference to C, whose account in A's books will be offset by an entry on the credit side with B's name appearing in the "Remarks" column.

On B's books the names of C and A will appear respec-

tively as offsets against the purchases and sales made with C and A. Thus the same result will be accomplished as on C's books.

On C's books the names of A and B will establish a cross-reference and set-off against the contracts bought and sold.

10:30 A.M. Bids

At 10:30 each morning prices known as the "10:30 Bids" appear on the cotton ticker. These bids are used as an arbitrary settlement price on "rings." Taking the foregoing hypothetical transactions between A, B, and C, it can be readily seen that in the offsets one factor is missing—the price of settlement.

Assume that A's 500 May were sold to B at 12.60 and purchased from C at 12.40. In the offset columns in the accounts of B and C, there will now appear 500 May at 12.10, and in the "Remarks" column the letter "R," indicating that this price is the ring or settlement price of that particular option on that day. Disregarding for the moment the principle involved in these transactions, A will receive \$500 in settlement of the difference between 12.40 as the purchase price and 12.60 as the sale price, on 500 May cotton. Employing now the 10:30 bid price of 12.10, the amount received by A should be the same.

In proving this statement, it will be found that \$1,250 was received from B in settlement, and that a payment of \$750 was made to C, or a net difference received by A of \$500. This is derived in the following manner: It will be remembered that the contract was sold to B at 12.60 and offset at 12.10. This results in a difference in A's favor of 50 points on 100 bales, or 250 points on 500 bales. Resolved into terms of money, this is \$1,250. It will also be recalled

that A purchased from C 500 May at 12.40. Using the same settlement price of 12.10, a difference of 150 points exists in C's favor which, in terms of money, contemplates a payment to C of \$750, leaving a balance of \$500 to A's credit.

Ring Clerks and the Clearing House

A word of explanation may be given here as to how the ringing method is carried out in practice. The New York Cotton Exchange has established a clearing house of its own, where the ring clerks of the various cotton brokerage houses assemble each morning. Each clerk has in his possession a slate book containing the names of purchasing and selling brokers, and the number and classification of options which each broker has open on the Street ledger. A's clerk makes it his business to see B's clerk, or vice versa. An exchange of names then goes on until A calls the name of C. Immediately the possibility of ringing the 500 May presents itself. The ring is called off by the party making it. Thus, if A makes a ring with C, the names in the ring run as follows: A sold to B, B sold to C, C sold to A; A being the first and the last name. The same course is gone through by the ring clerks until as many rings have been made as are possible. Rings made on one day are settled the next business day, together with any direct settlements which may have been made between brokers.

3. Street Let-out

Very often ringing becomes difficult by reason of the inability to get buyer and seller to pair off their contracts. Thus, A who sells to B and buys from C, cannot set off B's name against C, owing to the fact that B and C have no immediate relationship between themselves. Only when B and C have such a relationship is ringing possible. Such

a condition is met by the third method of settlement known as the "Street Let-out."

This system contemplates the giving up of names on either purchase or sale, upon the request of the broker seeking the "let-out." The following case will illustrate the method: A sells to B 1,000 January and purchases from C the same quantity of contracts. A is unable to ring with either B or C, because they do not trade with each other. In order, therefore, to effect a set-off in B's account, A must secure 1,000 January on the opposite side of the Street ledger. B does not sell to any broker from whom A buys. But if B should sell 1,000 January at any time, the names of the brokers purchasing from B are given to A in substitution for B's name. This would have the effect of an offset in B's account, and would further place upon the books of A the names of brokers which B substituted for his own.

The settlement price used in this case is the price obtained by B on his sale of the January contracts. In other words, what B really does is this: He exchanges the names of the purchasers in that transaction for the name of A. In this way the original purchase by B from A would be offset by this later sale by B. For example, B in this sale sells to four other brokers, D, E, F, and G. B then notifies D, E, F, and G that he "gives up" A in the transaction, thereby effecting a change in the name of the principal. A then offsets the contracts in B's account with the names and prices given by B. Where formerly there was one single name with which to ring, in this case there are four. An abundance of names is conducive towards easier ringing.

To further explain the settlement price used in this transaction, the following illustration will serve: A sells the original contracts to B at 12.60. This will appear in the Street ledger on the right-hand side of B's account. If B should then sell 1,000 January at 12.40 and in effect give up,

or eliminate himself as the principal in the transaction, the name of A would appear as the seller. A would then open accounts for D, E, F, and G, stating the account, the date of let-out, the number of bales, and the price, with the additional information in the "Remarks" column that the entries appear by reason of a let-out. B accepts A's name in lieu of the names of D, E, F, and G. The account of B therefore will contain an entry on the left-hand side of the folio reflecting the offset by 1,000 January at 12.40, with cross-reference in the "Remarks" column alluding to the accounts of D, E, F, and G. A would then "bill" B for 20 points on 1,000 bales, or \$1,000.

Thus, by the let-out system, A can substitute the names of D, E, F, and G, for B's name. He then substitutes the sale price of 12.60 for 12.40, and collects the difference from B.

This entry can be traced to the Street blotter (see Forms 42a and 42b) but does not go beyond that record. The purchases and sales book is not concerned in this transfer, and furthermore, as the offset on either side of the Street ledger was made at 12.40, the eventual financial result would not be altered.

4. Tender of Notice

The fourth and last means of settlement is the transferable notice or tender of delivery. It is the simplest method in operation, resembling very much the principle behind the ringing system.

At the expiration of the current option month, the purchasing broker of a contract—100 bales—receives a notice from the broker issuing the same, stating that the latter is prepared to deliver 50,000 pounds of cotton at a price stated in the notice.

If A sold to B and bought from C, the latter might issue

or transfer this notice to A, who in turn would transfer it to B. A relationship is then created between A, B, and C, which resolves itself into a ring. Thus, A tenders to B, and C tenders to A; or, leaving A out of the transaction, C tenders to B on account of A.

The same method of offset is used here as in the preceding method of settlement, except that in the "Remarks" column appears the information that the contract was tendered, and cross-reference is made to the transferee and transferor.

The settlement price will, of course, be the price mentioned in the "Transferable Notice," and is treated in the same manner as the 10:30 bids, or the ring prices.

Clearing House Payments on Settlements

In the foregoing discussion mention has been made of payments and receipts between the various brokers on the Exchange. To facilitate such settlement, the New York Cotton Exchange has established a clearing house in charge of which is a representative from a prominent New York bank.

Each morning a clearing house sheet is filed by the members availing themselves of the clearing house privilege. (See Form 43.) It contains a list of the brokers from whom balances are claimed or to whom balances are owed. The net difference between the two sides will result in either a payment to, or draft on, the Clearing House.

The accuracy of this system is aided by the established custom among brokers of depositing with the clearing house clerk the bills (Form 44) arising out of any of the four methods of settlement already described. Only such items as are stated on the bills are entered on this clearing house sheet. Thus the clerk of each brokerage house is in a position to check the accuracy of the bill which he receives. If

nothing be said to the contrary, the bill is presumed to be correct and the item is listed on the sheet.

The Clearing House receives as much money as it pays out against clearing house drafts. Only money balances are listed, no attention whatsoever being paid to the source of issuance. In effect, the Cotton Clearing House resembles the Bank Clearing House more than does the Stock Clearing House.

Brokers' Statement or Settlement Book

The clearing house settlements discussed above are entered in a "Brokers' Statement" or "Settlement Book," shown in Forms 45a and 45b. The first of these presents the payment side of the book, corresponding to the "We Owe to" shown in the clearing house sheet (Form 43). The second shows the collection side, which corresponds to the "We Claim from" column of the clearing house sheet.

The purpose of the settlement book is to record the receipts and payments on settlements, stating the name of the broker from whom settlement is received or with whom settlement is made. Besides this information it gives the source of receipt or payment by reflecting in special columns the respective months on which payment is made or settlement received. It is the basis for making up the clearing house sheet.

The date appears at the top of the page, and on the debit or payment side are columns for the name of the broker; the number of bales settled with each broker; eight special monetary columns for the respective option months on which payment is made; and a "Total Amount" column. In this last column appears the cross-footing of all the other columns.

The same arrangement obtains on the credit or collection side. The difference between the two "Total Amount"

columns will result in either a cash receipt from, or a cash payment to, the Clearing House. This difference should be identical with that appearing on the clearing house sheet.

CHAPTER XXI

CONTRACT DIFFERENCES AND THE POINT BALANCE

Requirements as to Records

The records of the cotton brokerage business must be kept up to the mark. This is even more necessary here than in the stock business, for the day's operations depend absolutely upon the information furnished by the various accounting media. If customer X desires to sell his longs or cover his shorts, recourse must be had to X's account in either the customers contract book or the customers margin sheets. In the course of a day's transactions, several telegrams from out-of-town clients are received, in which orders are given to close out longs or cover shorts, not stating in what options such customers are interested. This illustrates how essential it is to have the accounts completely written up. To exercise a double check upon the accuracy of customers' holdings, it becomes necessary for the margin clerk and the bookkeeper to compare open contracts of clients very frequently.

At any given time, also, it should be possible for the Street clerk to prove the net interest, long or short, taken from his Street books, with the net number of bales long and short as they appear in the customers' records. Classifying the various contracts into months, the net interest in each option can also be determined, upon the theory that the same purchases and sales, leading up to the determination of the net long and short, are passed through both divisions—customers' and Street. As was indicated, the Street section

concerns itself with the settlement with brokers, always having as an objective the reduction of all closed contracts to a condition where the net interest in the market approximates the customers' net interest.

It is easily seen, therefore, that there may be a wide divergence between the books of the two divisions. Suppose X, Y, and Z purchase in the aggregate 5,000 bales of various options, and that customers M and N sell 3,000 bales of different months. The net interest which the broker has in the market for the account of his customers is 2,000 bales, net long. Even if we suppose that all the contracts traded in have been in the January option, no "close out" or settlement by account sales can be made with the customers, because the purchases and sales have been made for several different accounts. Only where a client buys and sells the same option month, can an account sales be rendered to him. The status of the accounts, individually taken, would be such that long contracts would be shown for some customers, while short contracts of the same option months would be revealed for other accounts.

The Street division takes no cognizance of such a condition existing among customers. As before stated, its purpose is to settle contracts of the same month regardless of other conditions. If a direct settlement, a ring, or Street let-out be possible, it can be said with certainty that the 3,000 January bought and sold in the foregoing illustration, would be settled before—and probably long before—the respective customers liquidated their holdings.

Contract Differences Account

This brings us again to the subject of "Contract Differences." If one division of the broker's office works in total disregard of the apparently logical succession of operations involved in the settlement of contracts, then the results

obtained from the Street books will be in apparent contradiction to those obtained from the customers' records. This fact was emphasized in the preceding illustration of 3,000 January upon which payment was either made or received long in advance of any charges or credits being made in customers' accounts.

A thorough understanding of the theory upon which the Contract Differences account operates makes necessary the division of the subject under two headings:

1. Treatment of the customers' transactions as open contracts and liquidated contracts.
2. Treatment of the same transactions with brokers in the Street as contracts open and contracts settled.

Transactions which are settled for customers, representing purchase and sale, create either a debit or a credit to Contract Differences as explained in Chapter XVIII. A debit to that account signifies that the Street owes a sum which would equal the gross profit of the customer on a given transaction. A credit to the account under discussion evidences the liability of the broker to the Street on account of his customers' losses. Excluding all other factors at this point, the difference—the Contract Differences account—reflects a sum owing to or by the Street. Of course, this case presupposes that all customers' holdings, long and short, have been closed. If such be the case, then the immediate relation between the customers' books and the Street books is not so greatly strained.

But this, however, is seldom the case. The broker is an agent. As such he is called upon to settle with the Street on account of his customers' losses, and collect from it by reason of his clients' profits, and unless the Street division is able to settle the contracts in question with equal rapidity,

or vice versa, the results shown by the customers' books and the Street books may be widely different.

In the case of a loss, the Contract Differences account shows the corresponding liability to the other Street brokers. For instance, if the total loss be \$800, a payment of cash to the Street will offset the Contract Differences account by a debit to it and a credit to cash. This simple operation, hypothetical as it may be, illustrates one phase of the Contract Differences account.

As soon as the element of practice enters the discussion, the Contract Differences account assumes a very different aspect. For instance, the contracts from the Street end might create charges or credits long before or long after the contracts were settled in the customers' accounts. In conclusion, this statement can be made: If all contracts were closed with the Street and with customers, let us say at a period of dissolution, the net losses or the net profits on customers' contracts would equal the amount of cash paid to or received from the Street.

How, then, is it possible at any time to prove the correctness of the Contract Differences account? How is it possible to prove the accuracy of the debit, representing an asset, or the credit, representing a liability?

Point Balance

The answer to the foregoing question requires a discussion of the "Point Balance" method of reconciling the Contract Differences account.

The closed contracts of customers and settled contracts in the Street, give rise to charges and credits in the Contract Differences account. The open contracts of customers and unsettled contracts in the Street will, when finally liquidated, create further charges and credits to the account in question. But meanwhile it becomes necessary to reconcile the Con-

tract Differences account, for the reason that only through it is a control of the Street books made possible.

The presumption that this question is one for the auditor to answer is erroneous, because a constant check upon the Street books is essential to assure accuracy in the operation of the business. For this reason a point balance is taken at the close of each month's transactions to prove the balance which is to be found in the Contract Differences account. The process of taking a point balance can best be explained by a concrete example such as would be found in actual practice. We will therefore follow a series of items through the customers' division, and the same items through the Street division as well. On January 22, the following purchases were made for a client:

200	March	at	12.60
300	"	"	12.70
500	"	"	12.75

Also the following purchases for other clients:

200	July	at	12.50
300	October	"	12.32

On January 6, the customer who purchased 1,000 March, sold:

400	March	at	12.82
100	"	"	12.81

leaving a balance long of 500 March at 12.75.

On January 8, 500 July were sold at 12.31, representing a short sale of another client.

On January 10, 500 December were sold at 12.20.

From the customers' standpoint, the only transactions which would be closed by an account sales seem to be the 200 March at 12.60 and 300 March at 12.70 against the sale

of 400 at 12.82 and 100 at 12.81. The gross profit to the customer would be 79 points, or \$395. Consequently the Contract Differences account would be charged with a like sum, the customer be credited with \$295, and the Commission account with \$100. We are primarily concerned with the charge to the Contract Differences account, for it is this account which is to be treated in relation to the point balance, the other factors such as commission and customers' charges or credits, having no present bearing.

The only charge thus far in the Contract Differences account is \$395. What operations have gone on in the Street division? Let us assume that the 500 March bought at 12.75 were settled against the sale of 400 at 12.82 and 100 at 12.81. This settlement might have been made directly; that is, the same broker may have been dealt with in both purchase and sale. This condition, however, is not a usual one. Secondly, the 500 bales on either side might have been settled by ringing. It is of minor concern to the broker through what means a Street settlement is effected. This settlement might have been made a week or ten days after the customer's liquidation. On this particular Street transaction the broker will have received from the Clearing House or from the second broker direct, 34 points or \$170. This is arrived at in the following manner, considering these three transactions:

500	March	bought	at	12.75
400	"	sold	"	12.82
100	"	sold	"	12.81

The difference between 12.75 and 12.82 on 400 bales is 28 points, and that between 12.75 and 12.81 is 6 points, making a total of 34 points, or \$170. The Contract Differences account would receive credit for this amount against the receipt of cash.

Proof of Contract Differences Account

Assuming that the last of the month has arrived, we will set about proving by means of the point balance system, that the debit balance of \$225 appearing in the Contract Differences account is correct. The following eight steps are employed to obtain this proof:

1. As all contracts are resolvable into points, proceed to extend all open contracts of customers in this manner. Thus, on the purchase side of the Customers' Open Trades account, Form 46, the points representing the open contracts, are determined as follows:

500	March	at 12.75	equals	6,375	points
200	July	" 12.50	"	2,500	"
300	October	" 12.32	"	3,696	"
Total				12,571	"

2. On the sales side the points are found as follows:

500	July	at 12.31	equals	6,155	points
500	Dec.	" 12.20	"	6,100	"
Total				12,255	"

3. Deduct the lesser number of points from the greater. Thus: $12,571 - 12,255 = 316$ points debit.

4. Construct a "dummy" ledger account called "Contract Differences" and apply this debit of 316 points to the credit side of the dummy. (See Form 48.) Resolved into terms of money, this would be equivalent to \$1,580. Enter on the debit side of the dummy account the balance of \$225 from the true Contract Differences account. The dummy account then contains two factors:

- (a) The debit of \$225 as taken from the true Contract Differences account; and
- (b) A credit of \$1,580, which is the amount just applied as a test figure.

5. This step deals with the working up of figures of the Street division. (See Form 47.) On the purchase side, the Street ledger will contain the following open contracts, which are shown resolved into points:

200	March	at 12.60	equals	2,520	points
300	"	" 12.70	"	3,810	"
200	July	" 12.50	"	2,500	"
300	October	" 12.32	"	<u>3,696</u>	"
Total.....				12,526	"

6. The open contracts on the sales side of the Street ledger, resolved into points, are:

500	July	at 12.31	which equals	6,155	points
500	Dec.	" 12.20	" "	<u>6,100</u>	"
Total.....				12,255	"

7. Deduct the lesser number of points from the greater. Thus: $12,526 - 12,255 = 271$ points debit. Resolved into terms of money, this equals \$1,355.

8. Apply this \$1,355 to the debit side of the Contract Differences dummy. This account now contains debits of \$225 and \$1,355, making a total of \$1,580. This balances the credit of \$1,580, which proves that the Contract Differences account, as it appears in the general ledger, is correct. It also verifies all the open contracts in the Street division and in the customers' division as to quantity and prices. Finally, it attests to the correctness of the work for the month, as far as the transactions and settlements are concerned.

If the foregoing transactions be multiplied a hundred-fold, as would be found in actual practice, the necessity of the point balance method would become infinitely greater.

Confirmation Slips

Before the bookkeeper in charge of the Street records attempts to compile the figures to be used in the point balance, he confirms or checks up with the brokerage concerns which hold the other end of the transactions, all open trades—whether purchases or sales—as to price and quantity. The confirmations are made by means of "Confirmation of Open Trade Slips," which are sent out by the bookkeeper to the other brokers for their signatures. These slips contain a request for their return to the broker issuing them. Thus the information for the point balance is really gathered from the signed confirmation slips, which serve as a check on the Street records and give a sound basis for facts and figures necessary for the point balance.

CHAPTER XXII

TRANSACTIONS OF A COTTON BROKERAGE HOUSE—GENERAL

Typical Transactions

The typical transactions of a cotton brokerage business most frequently encountered are :

1. Direct purchases
2. Direct sales
3. Hedging
4. Speculation
5. Straddles

1. Direct Purchases. Direct purchases by mills and spot merchants presuppose that the delivery of and payment for cotton are made as it is desirable.

Mill operators seldom enter the futures market, since they are able to satisfy all their needs by purchases in the spot market. However, the actual markets may be demoralized, and then resort is had to futures.

The spot merchant, on the other hand, uses the futures market for most of his business. He sells to the mill and immediately buys that option month in which he is expected to make delivery to the mill. Before the option becomes due, he may buy the cotton in the spot market and sell his futures. With the spots so purchased, he can then fill his contract with the mill.

2. Direct Sales. Direct sales by the planter contemplate the actual shipment of cotton and immediate payment therefor by the purchaser to the planter.

Suppose a cotton grower sells his cotton on a New York

contract. After the samples are classified, the cotton is sent on to a licensed warehouse, weighed and compared with the sample. The buyer comes into possession of the warehouse receipts and makes payment to the planter to settle the transaction.

This subject is treated more fully in Chapter XXV, in connection with spot market transactions.

3. Hedging. The hedging method of trading may be used by planter, spot merchant, or speculator. The planter seeks to protect himself against damages resulting from his inability to make delivery against his sale. Such inability might be caused by a failing crop. Again, he may have sold his product at a stated price, long before the cotton was in actual existence. Then, when his crop is realized, if there is a small supply throughout the country, the price of cotton may have risen 100 points. In that case, unless the planter has purchased futures against his contracted sale and thus protected himself, he will lose this increment.

The spot merchant, as already stated, uses the hedging plan much in the same manner as does the planter. The speculator hedges in order to escape additional loss on long contracts in a declining market, and on short commitments during an upward movement.

4. Speculation. Many traders make a close study of crop conditions and then speculate in futures on the basis of the information so acquired. Speculation in cotton futures is as prevalent as speculation in stocks. However, more factors enter into the price-making of cotton and other commodities than of stocks. Security values for the most part rise and fall on the basis of strength or weakness in earnings. The commodity markets, on the other hand, are so sensitive to financial, economic, and general commercial conditions, that a close study of all these conditions is essential to operation in, or an understanding of, the speculative phase of the

futures market. A study of price-making involves so many technicalities and is so broad that the subject of speculation cannot be treated in detail here.

5. Straddles. Another method of trading is known as the "straddle." Invariably, all contracts approaching the day of expiration sell either at a premium over other months or at a discount. Where the demand for immediate use is very large, the cotton which is most quickly deliverable will command the highest price, and as between March and May, March, which is the first expiring month, might sell at a premium over May. If the supply is extremely large, March contracts might sell below the price for May. For example, the operator who makes a study of supply and demand conditions, might purchase 500 March at 12.10 and sell 500 May at 11.92. This trade is made at a difference of 18 points between March and May. As the due date arrives for March delivery, the demand is small and the price drops so that the difference between the two months might be 65 points and a gross profit result of 235 points, or \$1,175. A transaction of this sort is known as a "straddle."

Notice of Delivery

All purchases whether they are direct, hedged, or straddled, are passed through the books in the customary way. When the option month in which the contract was made nears the point of expiration, the direct purchasers, such as the mill and the spot merchant, contemplate the actual receipt of the commodity. The hedger and the straddler make known their intentions to the broker before the "Notice of Delivery" (Form 49) is served on the latter to the effect that the person issuing the notice is ready and willing to deliver the number of bales of cotton called for by the contract.

Considering the first class of customers—the mill and the

spot merchant—the notice, when issued to the buyer, is “stopped.” This means that the person stopping the notice thereby signifies his intention to receive the cotton at the price which is set by the Exchange to operate as the notice price. (See Form 50.) The issuing broker, according to the tenor of the notice, indicates his intention to deliver to the person who “stops” the notice.

To illustrate, suppose White & Co. hold a contract with Fairfield & Co. for the delivery of 100 bales of January, purchased by White & Co. for the account of the American Cotton Mills at 12.10. Suppose further, that the concern issuing the notice is Hamlin & Co., and that the notice price is 13 cents.

The notice to deliver is always transferable; that is, the seller may transfer to the buyer, who in turn, may transfer, by a so-called indorsement, to any broker to whom the transferor might have sold the same quantity of the option concerned. This practice may continue throughout the day until the notice of delivery is stopped. In the illustration cited, the notice covering 100 bales of January cotton will follow the described course until it comes into the possession of Fairfield & Co. Then, within fifteen minutes from its receipt by Fairfield & Co., White & Co. will receive and stop the notice. The effect of these transfers is comparable to the ringing process of settling contracts which has already been explained. Eventually, White & Co. will receive a warehouse certificate upon payment of \$6,500, which is the cost of 100 bales at the notice price of 13 cents a pound.

Adjustment of Difference between Purchase and Notice Prices

The question may arise as to how the difference between the purchase price and the notice price is adjusted. In the

foregoing example, the 100 January was purchased at 12.10, which, resolved into terms of dollars, is equivalent to \$6,050. In White & Co.'s Street ledger, under the account with Fairfield & Co., the purchase price would appear as 12.10. After the notice has been delivered to White & Co., an offset must be made in the account to show the delivery by Fairfield & Co. While the direct purchaser will be called upon to pay \$6,500, instead of \$6,050, he will receive the difference of \$450 from the broker with whom he made the original commitment. That is, White & Co. would bill Fairfield & Co. for the difference between 12.10 and 13, which is 90 points, or \$450. But between the time of stopping the notice and of receiving the warehouse receipt, other items will have entered into this spot transaction, such as storage, insurance, labor, and sometimes freight charges. All these incidentals are charged to the customer.

Sales for Actual Delivery

Let us now consider how a sale for actual delivery is handled. Suppose a planter wishes to sell his output long in advance of the crop's realization. In accordance with the grading rules of the Cotton Exchange and the Department of Agriculture of the United States, he can sell only a classified standard grade of cotton. Assuming that his product comes within the classification, he sells through some broker in New York or New Orleans—in the present instance through Hamlin & Co. of New York. Upon the first notice day, Hamlin & Co. will be called upon to issue a notice. This they do. According to the rules, they must deliver the number of bales called for. Each notice (Form 49) calls for the delivery of 100 bales. The cotton is subsequently shipped, inspected, and graded. If it comes within the prescribed classification, the contract is settled by payment to Hamlin & Co. of the notice price.

Adjustment of Difference between Sale and Purchase Prices

Taking as a basis for further illustration, the purchase and sale of 100 January at 12.10, we will now see how the difference between the sale and purchase prices is adjusted from the seller's end. The option was sold to Fairfield & Co. at 12.10, entitling Hamlin & Co. to \$6,050. But according to the notice price they receive \$6,500 from White & Co. Turning again to the White & Co.'s Street ledger, we find under the account with Fairfield & Co., 100 January sold at 12.10; and we find also that the contract was offset at 13. Having sold at 12.10 but delivered at 13, Hamlin & Co. have received \$450 more than the original contract called for, which amount is due and payable to Fairfield & Co. Nothing need be said here as to the actual method of settlement pursued, as the four methods of settlement—direct settlement, ringing method, Street let-out, and tender of notice—have already been fully treated in Chapter XX.

Expiration of Options

Turning for a moment to hedged, straddled, and long transactions, it will be found that customers who are carrying the long side of an option approaching expiration, will invariably sell or be compelled to sell as soon as the notice is tendered. The broker to whom the contracts are sold is the person to whom the notice is immediately transferred, thereby consummating the deal.

Customers who are short of an option whose expiration is nearly due, usually cover or buy in the shortage in order to escape the liability of actual delivery.

On long contracts, the options must be disposed of as soon as the notice is tendered. On short contracts, however, the seller may remain short of his contract until

the last notice day. This is usually 12 o'clock noon of the last day of the month—Sunday excepted. Ten minutes is the time allowed for the transferring of notices on the last day. This is technically known as a "short notice."

Broker's Net Interest

A condition might exist where one customer is long and another short of the same month. From the broker's point of view, this is known as a "net interest." In practice it operates somewhat in this manner:

As soon as the broker receives a notice to deliver, he sends or transfers it to the person to whom he has sold. From the customers' standpoint, one would still be long and the other short of the month in question, but unless actual receipt and delivery is intended, the customers will be compelled to buy in the case of a short, or to sell in the case of a long, on or before the last notice day. If the short customer covers before this time, and notice of delivery is sent to the broker, it will compel the sale of the long contract immediately.

Borrowing a Place

Very often a customer having a heavy long interest in the market desires to carry his contracts until the last notice day—this for the reason that the price may greatly advance as the option nears expiration. Under the customary methods of business, long contracts cannot be carried beyond the time of receipt of the notice. Frequently assistance is rendered by a fellow broker who is short of the same option and, in this position, is allowed to remain short until the last notice day. He is therefore able to give a place to the broker carrying the longs. To carry out the arrangement, the notices as soon as they are received by the longs, are transferred to the broker who has offered

accommodation, and the "long" broker is then said to "borrow a place." Such a transaction has the effect of placing two fictitious entries upon the Street ledger. One attests that the long broker has "sold" the number of contracts covered by the notices to the accommodating party. The other entry evidences a "purchase" from the accommodated broker. As the price on either transaction is the notice price, the operation in itself constitutes an even settlement and a convenient set-off. The "accommodating" broker may cover his shortage and thereby incur the possibility of receiving a notice against such fictitious purchase. As he lends or gives names to the accommodated broker, he is forced to transfer the notices to the latter, who, upon receipt of the notices, is compelled to dispose of his longs in order that he may be able to transfer the notices in his turn. The entries attesting to the false purchase from, and sale to, the accommodating broker are then reversed. The effect of such a transaction is an even settlement, as the notice price would again appear on either side of the books.

The practice of giving or borrowing a place is in violation of the rules of the Exchange. It is mentioned here merely to indicate one of the methods of carrying long transactions beyond the fair time of actual receipt or compulsory sale of the cotton.

CHAPTER XXIII

TRANSACTIONS OF A COTTON BROKERAGE HOUSE—INCIDENTAL

Branch Offices

The vast majority of cotton brokerage concerns maintain branch offices throughout the South. This is done for the purpose of obtaining advices pertaining to crop conditions, and as a medium for procuring Southern business.

Solicitors

According to the rules of the Exchange, no concern may enter into a contract of employment between itself and solicitors for a period of less than one year. In most cases the renewal of such contracts naturally depends upon the amount of business which has been produced by the solicitors.

In order to keep account of the business produced by the solicitors, a production record is employed. This record (Form 51) gives the number of bales solicited during a day, week, month, and year, and the commission resulting therefrom. Opposed to the production figures are the factors of expense, including solicitors' salaries, traveling expenses, and rent for branch offices, if any. Deducting the total expenses of any solicitor from his production figures, reflects the margin of profit for that solicitor. The commissions are figured at \$10 for each 100 bales.

Each day's record of purchases and sales is analyzed for the purpose of allocating the respective units in the

proper solicitors' columns. The production record contains also a record of the business resulting from partners' production or "local" activities.

Floor Brokerage Business

Many Exchange members make a practice of executing orders for other brokers at a charge of \$1 for each 100 bales bought or sold. At the end of each month a bill is rendered which, when paid, is credited to an account known as "Floor Commissions Received."

Clearances

When a broker has bought and sold an option for his personal account, and does not desire to carry the contracts until settled, he may ask another concern to "clear" for him. Clearances can be compared to the ordinary purchase and sale for the account of a customer. The commission charged on such transactions is \$1.50 for the "round trade"; that is, for purchase and sale. The usual account sales is rendered, and the commission is credited in the regular way. At the end of the month, however, such items are segregated by means of a summary, and credited to an account known as "Clearance Commissions."

Carrying Transactions

Another source of income in the cotton brokerage business is derived through the carrying of transactions for other members of the Exchange.

A goodly number of the brokers speculate in the market for their own account. They seldom carry their own contracts, usually asking some other concern to carry their commitments. When these accounts are subsequently closed, a commission of \$5 is charged by the carrying broker on both the purchase and the sale; that is, \$10 on the round

transaction. Here, again, an account sales is rendered and the brokerage earned is credited to the Commission Earned account.

Change of Name or Price

Floor brokers executing orders sometimes act in the capacity of agent and principal at the same time. If a floor member receives an order to buy 100 January at 12.70, he may sell it for his own account. Later in the day he may make a purchase at 12.65 against this "short." After the close of the Exchange, he will request the principal in the original transaction to "change a name" or "change a price." In other words, he substitutes in place of his own name on the purchase of the January at 12.70, the name of the broker from whom the January at 12.65 was purchased.

To illustrate, let us say that the January at 12.65 was bought from Robinson & Co., that W. Spencer was the broker, and John Brown the customer. The entry on the purchase side of the blotter would then appear as follows:

Bales	From Whom Bought	Price	Customer
100	Robinson & Co.	12.65	W. Spencer
100	W. Spencer	12.70	John Brown

On the sales side the entry would be:

Bales	To Whom Sold	Price	Customer
100	W. Spencer	12.70	W. Spencer

The charge for such transactions is 50 cents for the purchase and sale combined. An account sales is rendered, and the brokerage is credited in the usual manner. All

such items are summarized at the end of the month, and passed to the credit of the Commission account.

Half-Commission Brokerage

Many of the firms having membership on the Exchange neither clear nor carry the commitments of their customers. There are various reasons for this. It is sometimes due to the fact that there is a reluctance to tie up money unnecessarily, as in original or Street margins.

In such cases, by arrangement with another concern, the first concern can conduct its business on a half-commission basis. That is, while the charge to the customer is the usual \$20 for the purchase and sale of a contract, the brokerage concern is only charged \$10 by the carrying house for every hundred bales bought and sold—that is, \$5 on the purchase and a like brokerage charge on the sale.

Under such circumstances, no Street books are kept by the half-commission broker, for the need for such records is never present. Nor is there any necessity for his keeping Contract Differences account, as this phase of the purchases and sales of each customer is the problem of the “carrying” house. For example, customer A through his broker who is operating on the half-commission basis, buys 100 January at 12.10 and sells 100 January at 11.90, thereby losing 20 points, or \$100. Adding the commission of \$20, his total loss is \$120. A’s broker instructs the carrying house to apply or close out 100 January bought at 12.10 against the sale at 11.90. As far as contract differences are concerned, there would be none. However, assuming for the moment that such an account is in operation, the credit to the account would be \$100, but immediately this amount would be offset by a charge to it and a credit to the carrying broker.

The question might properly be asked, "How, then, is the entry made on the books of A's broker?" It is made through the medium of the general journal, in this manner :

Debit Customer A.....	\$120.00
Credit Carrying Broker.....	110.00
Credit Commission.....	10.00

An account sales is rendered to the customer, but it acts only as material for the journal entry. Nothing more is done with it.

As may be inferred, no analysis journal is necessary in such transactions.

CHAPTER XXIV

TRANSACTIONS OF A COTTON BROKERAGE HOUSE—CLOSING THE BOOKS

Adjusting Entries

Before closing the books of a cotton brokerage house, a number of adjustments are necessary. The most common ones are:

1. Provision for reserve for depreciation on furniture and fixtures.

2. Provision for reserve for doubtful accounts receivable.

3. Provision for doubtful and uncollectible accounts receivable written off.

4. Provision for accruals of:

- (a) Interest on:

- (1) Street margins unreleased

- (2) Notes receivable

- (3) Notes payable

- (b) Rent

- (c) Office salaries

5. If securities be held for investment purposes, suitable provision should be made for any depreciation in market values.

6. All items under floor brokerage receivable or payable should be evidenced by the books, so that a proper accounting can be had of the earning or expense in connection therewith.

7. In businesses which are conducted on a cash basis, the usual tendency is to overlook items of expense for which no bills have been received. To avoid an over-

statement of profits, due to an understatement of expenses, suitable provision should be made for such items as bills due and unpaid, estimated traveling expenses, and the like.

Income and Expense Factors

The sources of income in the cotton brokerage business and the general expense factors incident to the operation of the business, including both main office and branch offices, are as follows:

Income Factors

1. Commission from all sources
2. Interest on notes receivable
3. Interest on Street margins
4. Interest on bank balances
5. Dividends on securities

Expense Factors

1. Rent of offices
2. Salaries
3. Advertising
4. Telegraph
5. Telephone
6. Ticker service
7. Market reports and bulletins
8. Postage
9. Stationery and printing
10. Legal services
11. Collection on out-of-town checks
12. Traveling expenses
13. Entertainment

THE FINANCIAL STATEMENT

I. STATEMENT OF INCOME

1. Income from operation

The main source of income from the operation of the business is commission derived from the various sources already explained.

II. ADMINISTRATIVE EXPENSE

1. Rent of offices
2. Salaries
3. Advertising
4. Telegraph
5. Telephone
6. Ticker service
7. Market reports and bulletins
8. Postage
9. Stationery and printing
10. Legal expense
11. Collection on out-of-town checks

III. BRANCH OFFICE AND SOLICITORS' EXPENSE

1. Branch office rent
2. Agents' and solicitors' salaries
3. Traveling expense
4. Entertainment expense

IV. NET INCOME FROM OPERATION

The net income from operation is determined by deducting the total expense from the income; i.e., $I - (II + III)$; or, $I - II - III$.

V. SECONDARY INCOME

Aside from commission, which is the main source of income, the following four items may be considered as secondary income:

1. Interest on notes receivable
2. " " Street margins
3. " " bank balances
4. " or dividends on securities

VI. INCOME FROM ALL SOURCES

This is derived by adding the net income from operation and the secondary income, i.e., $IV + V$, which is the same as, $I - II - III + V$.

VII. DEDUCTIONS FROM INCOME

There are two items of expense which must be deducted from the income, in order to obtain net income; viz.:

1. Interest on notes payable
2. Exchange on out-of-town checks

VIII. NET INCOME

If the total of "Deductions from Income" is taken from "Income from All Sources," the result is the net income, which may be written thus: $I - II - III + V - VII$; or, $(I + V) - (II + III + VII)$.

IX. PROFIT AND LOSS CHARGES

Under this heading will be brought:

1. Loss on uncollectible accounts
2. Loss on the sale of securities held for investment.
3. Provision for reserve for depreciation of furniture and fixtures.
4. Provision for reserve for doubtful accounts receivable.
5. Provision for reserve for sundry accounts payable.
6. Provision for reserve for traveling expenses.

X. PROFIT AND LOSS CREDITS

1. Recovery on doubtful accounts receivable.
2. Profit on sale of securities held as investment.

XI. PROFIT AND LOSS

Deduct the profit and loss charges (IX) from the profit and loss credits (X), or deduct X from IX, as the case may be, and the net profit and loss debit or credit will be the

resultant. Applying the net profit and loss debit or credit (XI) to the net income (VIII), (adding in case of a credit and subtracting in case of a debit), the net surplus for the accounting period will be determined.

The distribution of this surplus, according to the articles of copartnership, will be the final operation in closing the books.

THE BALANCE SHEET

Assets

CAPITAL ASSETS

The only items which ordinarily appear as capital assets are:

1. Furniture and fixtures
2. Securities held for investment
3. Membership on exchange

CURRENT ASSETS

Under this heading are the following items:

1. Cash on hand and at banks
2. Accounts receivable—considered good
3. Street margins
4. Notes receivable
5. Accrued interest on Street margins
6. Accrued interest on notes receivable
7. Contract differences (this may sometimes appear as a liability)

DEFERRED DEBITS

Under the heading of deferred debits may be listed the following items:

1. Rent paid in advance
2. Membership dues paid in advance
3. Insurance paid in advance (on spot transactions)

4. Telephone privilege on New York Cotton Exchange, paid in advance

Liabilities

CAPITAL LIABILITIES

In the cotton brokerage business there are seldom found any capital liabilities. For the most part, all the debts of the concern are current in nature. The usual liability and proprietorship items may be listed under the two headings "Current Liabilities" and "Proprietorship," as shown below.

CURRENT LIABILITIES

1. Customers' accounts payable
2. Notes payable
3. Interest accrued on notes payable
4. Salaries accrued
5. Contract differences (this may be on the asset side of the balance sheet)

PROPRIETORSHIP

Reserves:

1. Reserve for depreciation on furniture and fixtures
2. Reserve for depreciation on security investments
3. Reserve for traveling expenses
4. Reserve for other expenses for which no invoices have been received

Capital:

1. Partner A's capital
2. Partner B's capital
3. Partner C's capital

In discussing the liability item "Customers' Accounts Payable," reference must again be made to the table of equities treated on page 121. The fact that a customer's

account shows a credit balance of \$1,000, is no indication that such an amount is owing to him. What must be considered is the loss or gain reflected in his open contracts.

The balance sheet should never be read without reference to the table of equities.

The listing of all assets and liabilities in the table of equities is less urgent in cotton brokerage than in the stock business. In cotton brokerage it will be sufficient to compile a statement of margins for the sole purpose of determining the status of the customers' accounts and the relation which this bears to the financial strength of the business in general.

Dissolution

Both the voluntary and involuntary dissolution of a stock brokerage business were treated in a general way in Part I, and that discussion applies to cotton brokerage as well. It may be said, however, that the customers' interests are not as well guarded in the case of a forced dissolution of a cotton brokerage house as in the failure of a stock brokerage house. In the latter case the customers have their securities to fall back upon, while in the cotton business the only realizable asset outside of those which are unimpaired, is the membership seat, worth approximately \$15,000.

CHAPTER XXV

SPOT COTTON

Technicalities of the Spot Market

In discussing cotton brokerage accounting from the standpoint of the futures market, we have seen that, for the most part, settlement among the brokers is made by means of the "differences" system. That is, the actual receipt and delivery in satisfaction of the options bought and sold are seldom availed of, but in the great majority of cases contracts are closed by means of "rings," "let-outs," "direct settlements," or "notice settlements," long before these contracts expire. To such an extent is this carried as to create the erroneous impression that speculation alone is the motive prompting such transactions.

Although in spot market transactions, very little actual accounting is required as compared with purchases and sales in the futures market, there is probably nothing else in the business of brokerage so involved in technicalities. The system employed in "taking up" a contract, or making delivery against an option sold, is so different from anything found in general business as to deserve further treatment in its accounting phase.

Details of Actual Delivery

The intention to "take up" a cotton contract is manifested by the stoppage of the "transferable notice." The last holder is charged with the duty of informing the broker issuing such document, that the former has in his possession the notice in question and makes demand for the delivery of

the cotton within two days from the date of the issued notice. This is done by means of a "Demand Form" (Form 50) stamped in attestation and delivered to the broker upon whom the demand is made. Such is the procedure attending a stoppage of notice. The new contractual relations between the brokers in the transaction are recognized by the Superintendent of the Exchange, who may demand the fulfilment of the contract between the parties.

As an illustration of the foregoing, let us assume that a purchase of 100 bales of December cotton is made in May at the price of 12.10. When the notice day comes, if it is the intention of the buyer to assume the contract, he will go through the stoppage of notice formalities just described; and upon the third day from the date of notice, documents known as "Grade Certificates" will be delivered by the seller to the buyer for examination. At the same time the seller delivers to the buyer a "Spot Bill."

The grade certificate states the number of bales which each document represents; the markings for identification purposes; where the cotton is stored; when inspected by the Exchange authorities; when the certificates expire; and the grades of cotton in each case. This grade certificate is a document issued by the Classification Bureau of the Exchange.

The spot bill (Form 55) contains a full statement of charges and allowances covering the "weight price." It also states the cost for inspection, classification, certification, and storage. Allowances for grade, weight, and storage of cotton are items which must be studied independently, if they are to be thoroughly understood and applied in practice.

On the third day after notice, warehouse certificates covering the actual commodity are delivered and the cotton is paid for. This terminates the contractual relationship between the brokers involved in the transactions.

Accounting Entries for Actual Deliveries

The first accounting entries when delivery of cotton is made, are for the purpose of getting the option out of the customers contract book. This is accomplished by first making a memorandum journal entry to the effect that the contract has been taken up. Then in the space provided for the sale, in the customers contract book, the word "received" is inserted and reference is made to the number appearing on the warehouse certificate. This takes the transaction out of the contract book. The charge to the customer covering the cost of the cotton is made through the cash book. In transactions of this sort, commission of \$25 per contract is debited to the customer through the general journal. These are the initial entries to the customer's account.

The treatment in the Street books is the next logical consideration. The fact that the cotton was received requires an entry in the nature of an offset against the purchase as it appears in the Street ledger. It will be recalled that the brokers' accounts, as they appear in that ledger, show the purchase from, or the sale to, the broker keeping the record. For example, if 100 December at 12.10 were purchased by Fairfield & Co. from White & Co., the purchase would be entered on the left side of White & Co.'s account in Fairfield's Street ledger, as shown by Form 52. If White & Co., or some other concern for their account, delivered warehouse certificates in fulfilment of the contract, some entry would be made in the blotter to the effect that 100 bales of December were tendered on notice at the notice price. Assume, in this case, that the notice price is 12.40. This information would be posted on the right side of White & Co.'s account in the Street ledger, and a bill would be sent to White & Co. for 30 points, or \$150.

At this point a question may be raised as to the collection of the \$150. A clearer conception of the principle

involved may be obtained by confining the transaction to specified limits; i.e., the effect of settlement on, (a) White & Co.; (b) the broker receiving the cotton; and (c) the person who makes delivery for White & Co.'s account.

Suppose, in this connection, that White & Co. sell to Fairfield & Co., and buy from McFarland & Co., the 100 December at 12.10; and McFarland & Co. issue the transferable notice at the stated price of 12.40. McFarland & Co. send the notice to White & Co., the concern which purchased from them, and White & Co. send it to the firm which elects to receive the cotton, Fairfield & Co., collecting from this firm the amount based upon the notice price. The settlement between Fairfield & Co. and White & Co. is effected by the payment of \$150 by the latter to the former.

It now remains to effect a settlement between McFarland & Co. and White & Co. This latter firm bought the cotton at 12.10, and upon transfer of notice was forced to settle with Fairfield & Co. at 12.40. The contract was made with McFarland & Co., who are then billed by White & Co. for 30 points or \$150. McFarland pays the \$150 but, as already explained, receives this difference from Fairfield & Co., the firm taking up the cotton at the time the spot bill is sent to the latter. Forms 53 and 54 illustrate the settlement between White and McFarland.

Limits of a Cotton Contract

According to the rules of the New York Cotton Exchange, a contract weighing between 49,500 and 50,500 pounds must be received in fulfilment of a transaction. So long as the weight is within these prescribed limits, no importance is attached to the number of bales involved. Thus, instead of containing 100 bales, a contract might run from 4 to 8 bales over or under that number. If 92, 108, or some other number of bales make up the necessary weight,

their delivery comes under the regulation clause and is a good delivery.

The laws of the Exchange provide that an allowance of $1/2$ pound per bale for each month or fraction of a month, be made to the buyer, from the time cotton is stored until the date of transfer.

Let us assume that warehouse certificates show that 92 bales of cotton, covered by such certificates and weighing 49,838 pounds, were in the Manhattan Stores, on May 26, 1915. In this hypothetical transaction, if the cotton was stored on May 26, 1915 and transferred on contract on December 31, of the same year, there would be an allowance in weight for seven full months and a fractional month, making, under the rule, a total of eight months. Allowing $1/2$ pound per bale per month for that period on 92 bales, the weight allowance would be 368 pounds. If this is deducted from the gross weight of 49,838 pounds, the net weight is 49,470 pounds. (See Form 55.)

Cost of Contract

Continuing the same transaction, the next point for consideration is the original cost of the contract. Multiplying the net weight by the notice price of 12.40, the result obtained is \$6,134.28.

Added to the original cost is the standard charge of 12 $1/2$ cents per bale for inspection, classification, and grading certificates. No matter how often the cotton is transferred from one buyer to another, these charges obtain. On 92 bales these incidental charges would be \$11.50, making a total cost of \$6,145.78.

Grades of Cotton

Under the rules of the New York Cotton Exchange, specified grades of cotton only may be delivered on contract.

The following grades are admitted by the Classification Committee :

Above Middling

Fair
 Strict middling fair
 Middling fair
 Strict good middling
 Fully good middling
 Good middling
 Barely good middling
 Strict middling
 Fully middling
 Strict good middling tinged
 Middling
 Good middling tinged

Below Middling

Middling
 Good middling tinged
 Barely middling
 Strict low middling
 Fully low middling
 Low middling
 Strict good ordinary
 Good ordinary
 Strict middling tinged
 Middling tinged
 Strict low middling tinged
 Low middling tinged
 Middling stained

Grade Premium and Discount

The basis for all grades is middling cotton. All grades above middling command a premium or an addition to the stated selling price, by reason of the superior and higher priced cotton entering the contract. On grades below middling, an allowance is made on account of the inferior quality of the cotton. Each grade except middling commands a certain number of points, premium or discount.

Reverting to the 92 bales of cotton stored May 26, 1915, let it be assumed that the delivery was as follows: 1 middling, 7 strict low middling, 12 fully low middling, 48 low middling, 23 strict good ordinary, and 1 good ordinary—making 92 bales according to the contract. All of these grades, excepting the middling, are below that basis, and are subject to a discount. On the 1 bale of middling the rate is "flat," meaning no discount or premium. On the 7 strict

low middling, the discount is \$.005 a pound, or a total of \$.035; on 12 fully low middling, the discount is \$.0085 a pound, making an allowance of \$.102; on 48 low middling at \$.0125 discount, the allowance is \$.60; on 23 strict good ordinary at \$.02 discount, the allowance is \$.46; and on 1 good ordinary, the discount is \$.03; the grand total being \$1.227. Now, if we multiply the allowance of \$1.227 by the net weight of 49,470 pounds (that being the poundage to be considered), and divide the product of \$60,699.69 by 92 (the number of bales contained in the contract), we will get \$659.78, which is the allowance made for the inferior grades.

Storage and Labor

The charge for storage and labor in connection with the warehousing of cotton is sometimes paid by the seller to the storage company up to the time of the sale. In the great majority of cases, however, the storage and labor charge is allowed to accumulate and is deducted by the seller from his spot bill to the buyer. The charge for storage is 20 cents a bale for each month, and 10 cents a bale for half months. The cost for labor is 10 cents "in" and 10 cents "out"; that is, 20 cents for putting the cotton in storage and taking it out. The "out" storage charge is paid by the buyer when he releases his cotton from store, while the "in" storage is allowed by the seller. In the case of the cotton stored May 26, 1915, the storage and labor were paid by the seller up to May 26, 1915. From that date until December 31, 1915, there would be seven full months of storage at 20 cents, and one half month at 10 cents, or \$1.50 for each bale. On 92 bales, therefore, the storage allowance would be \$138.

The total charges on this transaction are \$6,145.78, and the total allowances for grade, storage, and labor are

\$797.78; therefore the net cost of the contract to the customer, as shown by the spot bill, is \$5,348.

Customer's Contract Difference Credit

Let us recall for a moment the \$150 which the broker collected, for the difference of 30 points between the purchase and notice prices. What interest has the customer in this sum? The charge to him should be on the basis of 12.10. Therefore, if he was charged on the basis of 12.40, he is ordinarily entitled to the 30 points collected for him by his broker, and is credited with this amount; Contract Differences account being charged.

Insurance and Interest Charges

There are other minor charges in connection with spot transactions, such as insurance and interest, and a small charge for the storage of cotton samples. The addition of these charges consummates the deal.

The Spot Register

All the facts pertaining to spot cotton transactions must find suitable expression in some record arranged to show at a glance all details in connection with the purchase and the subsequent disposition, either by delivery against a futures sale or by direct shipment to the customer. Such a record is the "Spot Register" shown in Form 56.

Part III—Produce Brokerage

CHAPTER XXVI

PRODUCE BROKERAGE—ITS CUSTOMS AND RECORDS

Conditions and Customs

Under "Produce Brokerage," such transactions will be discussed as occur on the New York Produce Exchange and the Chicago Board of Trade.

Here, as in cotton brokerage, two markets exist: one in which spot or cash transactions appear; the other dealing with "futures." It may be said with safety that about 75% of all contracts are entered into for "future delivery." This being true, it becomes quite apparent that produce brokerage will, for the most part, concern itself with the futures operations. It is therefore this phase of produce brokerage accounting that is treated here.

The New York Produce Exchange, while it is nominally a market for grain, really does very little in this line. Occasionally, however, the "Pit" is the scene of large grain operations. The most prominent commodities dealt in are corn and wheat. Barley, rye, and oats find a better market on the Chicago Board of Trade. Concerning ourselves chiefly with dealings in corn and wheat, it is of importance to know, first, the methods of trading, and second, the accounting necessary to record the transactions.

When dealing in corn or wheat, the "contract," whether it be for "spot" or for "future" delivery, is 5,000 bushels. The price is quoted in cents and fractions of a cent per bushel, the fluctuations varying by eighths or multiples thereof. Thus, one contract of May wheat purchased at 96 $\frac{1}{8}$ cents per bushel will cost \$4,806.25. Occasionally, a double contract, i.e., 10,000 bushels, is traded at a "Split" price. For instance, if 10,000 May corn were purchased at the split price of 66 $\frac{3}{4}$ — $\frac{7}{8}$, it would mean that 5,000 bushels were purchased at 66 $\frac{3}{4}$ and 5,000 at 66 $\frac{7}{8}$.

The commission on grain, according to the laws of the New York Produce Exchange, is \$6.25 for each contract of 5,000 bushels purchased and sold; \$3.12 $\frac{1}{2}$ on the purchase, and a similar charge on the sale.

The most active option months for wheat and corn are May, July, September, and December. The methods of trading are very much the same as those in vogue on the New York Cotton Exchange. The only difference from the accounting standpoint is that the contracts are not settled by the "point differences" system. That is to say, the cost of the contract is resolved into dollars and cents, and the difference, loss or gain, immediately reflects a dollars-and-cents result.

Transferable notices and direct settlements operate as a means of settling transactions between brokers. "Ring-ing" is seldom resorted to as a matter of settlement, for the reason that the clearing house system works along such lines that ringing becomes unnecessary. Nor is the Street "let-out" an important factor of settlement.

Books of Account

In the customers' division of a produce brokerage concern, the following books will be most commonly found to record transactions in grain and oil:

Purchases and sales book
Customers margin book
Customers contract book
Analysis journal
Customers ledger
General journal
Cash book
General ledger
Street margin ledger

The ruling, arrangement, and uses of these records are identical in every respect with those of the corresponding books used in the cotton business. Comment is therefore unnecessary.

The Street books usually employed comprise the following:

Blotter
Street ledger
Clearing house ledger
Margin book

The Blotter; the Street Ledger

After the transactions are made on the "floor" of the Exchange, the customary "sign-up slips" form the basis of entry for the blotter. This record is very much like the blotter of the cotton brokerage business.

After the entry in the blotter is completed, this question is asked: Is the broker named in the transaction a member of the New York Produce Exchange Clearing Association? If answered in the affirmative, then the transaction is entered in the clearing house ledger. If answered in the negative, then the Street ledger becomes the second book for consideration.

This classification of brokers is necessary for the reason

that many members of the Exchange have no membership in the Clearing Association, which is a separate institution from the Produce Exchange proper, and this fact bears directly upon the entries made to record their transactions.

For instance, if broker A should purchase 5,000 bushels of May corn from broker B—neither of them a member of the Clearing Association—the transaction would rest after being expressed in the Street ledger. If, by chance, A should later sell to B, a direct settlement could be effected. While it has been stated that the ringing method is not used to an appreciable extent, it is nevertheless true that brokers, such as A and B, might attempt to settle transactions through this indirect means. This, however, is seldom done. It is very obvious, then, that transactions between two ex-clearing house brokers are carried along until the “notice day.” If A, using the same illustration, should receive a notice from B, the same would be transferred to whomever A might have sold.

Again, if in the preceding transaction, one of the brokers had clearing house privileges and one had not, the same method of entry would still operate.

The Clearing House Ledger

Transactions between clearing house members assume an entirely different aspect as far as entry and final settlement are concerned. In such case “sign-up slips” are exchanged and the entry is made in the clearing house ledger. All transactions expressed therein, attest to the fact that the items have been cleared by the Association.

Inasmuch as the volume of business to be passed through the clearing house ledger cannot be measured definitely, it is best kept as a loose-leaf device. The ruling and arrangement of the sheet should be such as to allow for the convenient entry of the date of the transaction, the quan-

tity, the price, and the broker of whom bought. The sales division of the record should provide similar information.

In the Street ledger used in the cotton business, several of these sheets are allotted to the respective Street brokers, depending altogether upon the diversity of the options bought and sold. In the grain market, however, all transactions appear as though the Clearing House was the second broker, handling the other end of the purchase or sale, and the folios of the clearing house ledger will be headed as follows: "Clearing House May Corn," "Clearing House July Corn," "September Corn," "July Wheat," "September Wheat," etc., etc.

This arrangement of the clearing house ledger shows how similar the relationship of the clearing house to the broker is to that which exists between one broker and another in the cotton business, and between two ex-clearing house members of the Produce Exchange. The Association must answer to the member clearing, and vice versa. One member cannot proceed against another on clearing house transactions. As soon as the trade is accepted by the manager for clearance, all claims are to be registered against the clearing institution. In a word, the contractual relationship between two clearing house members is severed as soon as the item is passed through the Clearing House.

The clearing house ledger is not a financial book. At best, it serves the purpose of tracing purchases and sales, if for any reason a review becomes necessary.

Closing the Books

The closing of the books necessitates adjustments similar to those treated under "Cotton Brokerage."

The income statement, balance sheet, and "Margin Tables" operate on the principles explained heretofore (Chapter XXIV).

CHAPTER XXVII

PRODUCE BROKERAGE—THE CLEARING HOUSE SYSTEM

New York Produce Exchange Clearing House Association

The Clearing House Association has for its purposes:

1. The settlement of purchases and sales among its various members.
2. The calling of original and market margins whenever necessary.
3. The final receipt and delivery of all notices.

It differs in every respect from the clearing systems of the New York Cotton and Stock Exchanges. It constitutes itself as intermediary between brokers to the extent that all purchases and sales are in effect assigned to it, thereby creating an actual contract relationship between the clearing house members and itself. In doing this, it becomes liable in case of breach of contract. To protect itself it demands:

1. The name of the broker with whom the transaction was made.
2. The constant adjustment of prices arising from the daily fluctuations, payable by check in the case of a market loss, and receivable by a draft on the Clearing House, where any market profit is shown.
3. The calling of original margins within twenty-four hours of the time in which transactions have been made.
4. The calling of market margins between 10 A.M. and 3 P.M., to adjust any differences in price

which might exist on open clearing house contracts by reason of a "wild" market.

Operation of the Clearing House System

Whenever a contract is made between two clearing house members, both are required to file a sheet with the Association before 10 o'clock on the first five business days of the week, and before 9:30 o'clock on Saturdays. Besides the sheet, statements known as "Bought Slips" and "Sold Slips" (Forms 57 and 58) must be filed.

A "Bought Slip" is made out for each class of grain, i.e., corn and wheat. The information contained in the "Bought" and also in the "Sold" slips is as follows:

1. Date of purchase
2. Name of the respondent member
3. Name of broker from whom purchased
4. Amount (in bushels)
5. Month (for instance, May corn)
6. Price
7. Settling price (clearing house)
8. Debit and credit columns (in which are stated either the loss or the gain between the cost and the clearing house settling price)

Taking, to illustrate the application of the clearing house settling price, the purchase of 10,000 May corn at $67 \frac{3}{8}$, assume that $67 \frac{1}{8}$ is the clearing figure issued by the Association at the close of business on that day. On this transaction the purchasing broker would be called upon to pay the Clearing House the sum of \$25. This amount would appear in the "Debit" or loss column of the bought slip.

The Clearing House Sheet

Let us now consider the clearing house sheet proper

(Forms 59, 60). It has six main divisions arranged as follows:

1. Contracts "Carried over for Tomorrow"
2. "Today's Trading"
3. Contracts "Carried over from Yesterday"
4. "Settling Price"
5. "Debit"
6. "Credit"

The first column is further subdivided so as to show: "Long," "Month," and "Short."

The second column is subdivided into: "Bought," "Month," and "Sold."

The third column contains information similar to the first.

The fourth column is subdivided into: "Yesterday" and "Today."

At the right-hand bottom of the sheet there will be found under the monetary columns, spaces for recording any losses or gains reflected on either the bought or sold slips. We also find that the sheet is subdivided into two sections, an upper and a lower, the first providing for wheat transactions and the second for transactions in corn.

To illustrate, let us suppose that the purchase of 10,000 May corn has been entered on the clearing house sheet. In the column which provides for "Today's Trading," we find under the corn section 10,000 May bought. As this trade was not "Carried over from Yesterday," it is to be inferred that all market adjustments were made on the bought slip.

Next, in the column "Settling Price" the clearing figure will appear under the heading "Today," and under the division which provides for the transactions "Carried over for Tomorrow," the 10,000 May corn will appear in the

"Long" column. In the monetary columns providing for losses or gains, as reflected by the bought or sold slips, the amount of \$25 appears as a debit opposite the caption "Bought Sheet." At the very bottom of the clearing house sheet these words appear:

Our }
Your } Check

By crossing out the unnecessary word, we indicate whether payment is to be made to or by, the Clearing House. In this case the word "Your" is stricken out. The check and the bought slip would accompany the sheet. (See Form 59.)

Considering the sheet of the next day (Form 60), we find in the column headed "Carried over from Yesterday," 10,000 May corn. If no additional purchases or sales are made, the same transactions are carried to the column headed "Carried over for Tomorrow." Let us assume here that the clearing house price of the second day was 65. In the "Yesterday" column the price of settlement appears as 67 1/8. In order to adjust the contracts to the market price, the settling price of "Today" is stated on the sheet. The difference between yesterday's price of 67 1/8 and today's price of 65 results in a market loss of 2 1/8 points on 10,000 bushels, or \$212.50. A check is drawn by the purchasing broker, payable to the Clearing House Association, and the sheet is deposited.

Clearing House Adjustments

All payments and receipts pertaining to clearing house adjustments are charged and credited to the account called "Contract Differences—Grain—Clearing House."

Clearing House and Customers' Settlements

The next point for consideration is the relation which such clearing house payments and receipts bear to the settle-

ments in customers' accounts arising from purchases and sales. If a customer purchased 10,000 May wheat at $92 \frac{1}{8}$ and sells these contracts at 94, he will realize a gross profit of $1 \frac{7}{8}$ points, or \$187.50. The customer will receive credit for his net profit, and the account of "Contract Differences—Grain" will be charged with the gross amount. Assume the purchase and sale to have been made through clearing house brokers on February 3 and February 6, respectively. How would the daily adjustments of settling prices affect these transactions? If, on the day of purchase the settlement figure were 91, a payment of \$112.50 would be made to the Clearing House by 10 o'clock A.M. on February 4. If the settlement price on February 4 were $93 \frac{1}{8}$, a draft on the Clearing House would be made for \$212.50, or the difference between yesterday's figure and today's. On February 5 the settlement price was $92 \frac{1}{2}$, and again a payment to the Association of \$62.50 would be necessary as an adjustment of prices.

On February 6, the 10,000 May wheat were sold at 94. At this juncture a sold slip would attest to the sale. The settlement figure would be applied on the sold slip. Let us assume that $93 \frac{5}{8}$ was the clearing house price. The sale having been made at 94, and the price necessary to bring the contract to the closing figure being $93 \frac{5}{8}$, the sum of \$37.50 would be carried out into the credit column of the sold slip. To the extreme right of the clearing house sheet, opposite the caption "Sold Sheet," \$37.50 would be reflected in the "Credit" column. We must remember, however, that "Today's" settling price is not as yet applied to the contract appearing on the sheet proper. If the settling price of "Yesterday" (the 5th) were $92 \frac{1}{2}$, and "Today's" figure $93 \frac{5}{8}$, an additional credit of \$112.50 would result in a draft being made upon the Clearing House for \$37.50 plus \$112.50, or a total of \$150. Now if we re-

view the payments to and from the Clearing House, we will find:

Payments:

February 3.....	\$112.50
“ 5.....	62.50

Total	\$175.00
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Receipts:

February 4.....	\$212.50
“ 6.....	150.00

Total	\$362.50
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The difference between payments and receipts is \$187.50. This amount appears to the credit of the Contract Differences—Grain—Clearing House account. The gross profit on the settlement by the customer was \$187.50. The Contract Differences—Grain account was charged with a like sum. Thus the relation of the daily clearing house adjustments to the final liquidation of customers' contracts becomes apparent. If at this point the business were dissolved, the Contract Differences accounts would be merged and the result would be a settled account.

Proof of Contract Differences—Grain Account

In order to prove that the transactions liquidated by customers have resulted in proper charges and credits to their accounts, and in order to ascertain the correctness of outstanding contracts, a proof is taken at the close of each month's operations. The balance in the Contract Differences—Grain account should be possible of reconciliation after the balance which exists in the Contract Differences—Grain—Clearing House account and the open contracts with the Clearing House, are applied. Let us suppose that the

debit in the Contract Differences—Grain account is \$50), resulting from the purchase of 5,000 bushels of May wheat at 94 and the sale of 5,000 bushels at 95, and that, according to the customers' books, there are still on hand 5,000 bushels of May corn "long" at 67 and 5,000 bushels of July corn "short" at 69. Taking the settling prices of the night previous, we find that the 5,000 bushels of May corn were adjusted to the market price of $68 \frac{1}{4}$; that the 5,000 bushels of July corn short also appear at $70 \frac{3}{8}$, that being the settling figure. As a result of the differences between the actual price of the May corn and the settling price, and the actual sales price of the July corn in comparison with its settling figure, a debit of \$6.25 appears in the Contract Differences—Grain—Clearing House account. It will be recalled that the sum of \$50 had been received from the Clearing House against the liquidated purchase of 5,000 May wheat at 94 and the subsequent sale at 95. Hence, three factors will be introduced to prove the accuracy of the Contract Differences—Grain account:

1. The unliquidated contracts of customers.
2. The unliquidated contracts as they appear upon the sheet.
3. The payments to, and the receipts from, the Clearing House.

1. Resolving the unliquidated contracts of customers into dollars and cents, we find that 5,000 May corn at 67 equals \$3,350, a debit; the 5,000 July corn short at 69 equals \$3,450, a credit. At this point we construct a "dummy" Contract Differences—Grain account, recording on the credit side \$3,450, and on the debit, \$3,350.

2. The items still open with the Clearing House are 5,000 May corn long appearing at the last settling figure of $68 \frac{1}{4}$. Resolving this into dollars and cents, the con-

tract would amount to \$3,412.50, which in the "dummy" account is to be listed under the credits. The 5,000 July corn "short" with the Clearing House, figured at the settling price of 70 $\frac{3}{8}$, amounts to \$3,518.75. This sum is to be treated as a debit in the "dummy" account.

3. Turning for a moment to the Contract Differences—Grain—Clearing House account, we find a credit of \$50 and a debit of \$6.25, or a net credit of \$43.75. This sum is to be treated in the dummy account as a debit. Then on the debit side the following items appear:

\$3,350.00
3,518.75
43.75

or a total of \$6,912.50

And on the credit side items for:

\$3,450.00
3,412.50

or a total of \$6,862.50

After footing the debit and credit columns of the dummy account, the balance is a debit of \$50 which supports the balance in the Contract Differences—Grain account.

The difference of \$50 between the two totals of the dummy account is proof positive that all transactions of customers have been properly liquidated; that all payments to and receipts from the Clearing House are correct; and that the unliquidated contracts agree as to quantity and price.

CHAPTER XXVIII

MARGINS

Original Margins

In a general way the customs and practices of the New York Produce Exchange are discussed in the present chapter. Between two ex-clearing house members in any transaction, the right is reserved by either one to demand original margin on contracts in wheat or corn, up to 5 cents per bushel, or \$250 for the contract. The call must be made within 24 hours from the time of the transaction.

All transactions cleared by the Association are also subject to original margin call. The manager of the Clearing House issues all calls, and the margin when deposited is made payable to the broker responding, or to the Clearing Association of the New York Produce Exchange, as the Secretary shall direct. The original margin requirements in a normal market are 1 cent a bushel on contracts long or short up to 250,000 bushels; 1 1/2 cents a bushel on longs or shorts from 250,000 to 500,000 bushels; and 2 cents a bushel on longs or shorts of 500,000 or over. When, in the opinion of the directors of the Exchange, the market is abnormal, the margin requirements may be greater.

Where a member is long of 100,000 May corn and short of 50,000 July wheat, he is said to have a "spread" on 50,000 bushels. In that case the Association would require 1 cent a bushel on the 50,000 net long, and 1/2 cent a bushel on the spread of 50,000 bushels. On spreads under 100,000 bushels, an original margin of 1/2 cent is demanded. On spreads of 100,000 or over, 1 cent a bushel is the

required margin. The requirements may, however, be increased or decreased upon short notice, to conform to market conditions.

Market Margins

Brokers without clearing house affiliations may call and may be called for market margin. Where there exists a difference between contract and market price, the broker in whose favor the market is "working" may demand the deposit of a sufficient sum to margin the open contracts. Whenever a contract is entered into between a clearing house broker and one without such special membership, the case remains the same. Market, and even original margin, must be deposited upon call. The difference between the two is simple. When original margin is required, both brokers must deposit, but in the case of market margin, only the person suffering from market loss must deposit. This is similar to the custom on the Cotton Exchange.

One of the rights of the Clearing House Association is to call its members for market margin whenever such call becomes necessary by reason of a wildly fluctuating market. Of course, the settling prices of the day would operate as an adjustment between the preceding day's settling price and the following day. But, conceive of a condition where the market breaks very sharply, directly after the sheet of the previous day has been deposited, and suppose that the broker is heavily long of corn or wheat. The Association must seek temporary protection, and to that end issues a call specifying the amount of market margin to be paid. The call is answered by paying the amount to the Association. When, however, the settling prices for the day in question have been determined upon, the broker who has been called for market margin during that day, may treat such margin deposit as a credit on the sheet. In such

case after the adjustments of settling prices have been made, the final result is either added to, or subtracted from, the credit appearing by reason of margin.

To illustrate, suppose that the market margin deposited upon call of the Association was \$2,000, and that after today's settling price has been applied to the long contracts, a loss of \$800 is reflected; then a draft for \$1,200 would be made upon the Clearing House.

From this it will be seen what adequate measures of protection have been adopted by the Association. In case a broker fails to respond to a margin call immediately, a condition of insolvency may be suspected and the Association exercises the right to close out all the commitments represented by the sheet. If any loss to the Association should result from the insolvency of a member, it is liquidated by the disposal of the stock which each member holds in the Association. His seat on the Exchange is also lost to the insolvent member.

Margin Details

All original and market margins called by non-clearing house members are depositable within a reasonable time after the call has been received. Such margin is made payable to any one of the designated banks or trust companies and is deposited with the Secretary of the Exchange. He acts in the same capacity as does the Superintendent of the Cotton Exchange. Interest at the rate of 2 to 3% is allowed by the depository.

Release of Margins

"Original" margins may be released after the contracts are settled between brokers; market margins are releasable when the market price again approximates the contract price.

In the case of Association brokers, the margin (all being original) is releasable:

1. After the contract is liquidated on the sheet by purchase or sale.

2. As to the excess margin, whenever any additional sale or purchase creates a "spread." For instance, if a broker were long of 250,000 May corn, he would be required to deposit original margin of \$2,500 (1 cent per bushel). If he should subsequently sell 250,000 May corn, all the original could be released. But, if instead of selling 250,000 May corn, his customers should sell only 100,000, then only \$1,000 could be released, representing the excess original margin. Or, if a broker were long of 75,000 July wheat, he would be required to deposit \$750 as original margin. If eventually he should decide to sell 75,000 July corn, thus creating a "spread," he could release \$375 in original margin for the reason that the requirements are only one-half cent per bushel on "spreads" under 100,000.

CHAPTER XXIX

CHICAGO BOARD OF TRADE BROKERAGE

The Chicago Board of Trade

Many Wall Street concerns have memberships on the Chicago Board of Trade. By being so affiliated, they may send orders to their Chicago correspondents for execution and in that way earn one-half the commission charged on all Chicago transactions. That is, without incurring any of the expense of clearing their own purchases and sales, a secondary commission is enjoyed by them.

On the Chicago market, the following commodities are listed for active trading:

1. Grain—comprising corn, wheat, oats, rye, and barley.
2. Provisions—embracing pork, ribs, and lard.

A cash market and a futures market are operated. Most of the business which is directed to Chicago by New York brokers falls under the second division, namely, that of the futures market.

It is not intended here to discuss the accounting on the Chicago broker's books, but the treatment of Chicago purchases and sales from the New York broker's standpoint.

The Grain Market

The methods of trading on the Chicago Board of Trade are very similar to those in vogue on the New York Produce Exchange. Wheat, oats, corn, rye, and barley are bought and sold by contract. Each contract contains 5,000 bushels. The price is quoted in cents and fractions of a cent ranging from one-eighth to seven-eighths. A fluctuation of one-

eightth is equivalent to \$6.25 on each contract. Sometimes a "double contract" consisting of 10,000 bushels is traded at a "split" price.

The commission charged on a purchase and sale combined is \$7.50 for each contract of wheat, corn, and oats. On transactions in rye and barley, the commission is \$12.50 for the combined purchase and sale; \$6.25 for the purchase, and a like charge on the sale.

Provisions

The purchase or sale of 250 barrels of pork is one contract. The price is quoted in so many dollars and cents per barrel. The fluctuations are 2 1/2 cents apart. To illustrate, assume the purchase of 250 barrels of pork at \$19.50. The next variation would be either \$19.47 1/2 or \$19.52 1/2. In the upward trend, the fluctuations would range as follows: \$19.50, 19.52 1/2, 19.55, 19.57 1/2, 19.60, etc. Each variation is equivalent to \$6.25. The commission is \$6.25 on the purchase and \$6.25 on the sale; a total brokerage of \$12.50.

A contract in ribs equals 50,000 pounds. The price is quoted in cents and hundredths of a cent per pound. The fluctuations are 2 1/2 points. Each change in price is equivalent to \$12.50. The commission is one-eighth of one per cent, or \$12.50 on the "round" transaction.

Each contract in lard contains 250 tierces. Each tierce is of the approximate weight of 340 pounds, or 85,000 pounds to the contract. The price is quoted in cents and hundredths of a cent per pound. The fluctuations are of the range of 2 1/2 points, or \$21.25 on one contract. The commission charge is \$15.

Commissions Charged New York Members

The New York members who have occasion to use this

market are charged a commission of \$3.75 for wheat, corn, and oats; \$6.25 for rye and barley; \$6.25 on ribs, \$6.25 on pork, and \$7.50 on lard transactions.

Accounting for Chicago Trades

No books of account other than those kept for the general business, are necessary to record the New York broker's Chicago transactions. To illustrate, suppose that Charles Fairfield & Co., members of the Chicago Board of Trade, direct their orders in Chicago futures through Long & Barnett of Chicago. The latter concern attends to the clearing of the contracts, the margins, and settlements. In other words, they literally carry the commitments until finally closed.

A page similar to that used for recording customers' purchases and sales in cotton, will answer the purpose in expressing all transactions in Chicago futures contracted for by New York customers. Thus, if customer A purchased 5,000 bushels of Chicago May corn at 67 1/2, one column under A's contract folio would be headed "May Corn Chicago" and all transactions therein be treated in the same manner as are cotton contracts. To evidence the purchase through the Chicago brokers, a column under Long & Barnett's contract page would reflect the transaction. But in this case the contract would be listed in the column for sales. In effect it would be made to appear that Long & Barnett had sold to Fairfield & Co., 5,000 May corn at 67 1/2. When the customer sells, an account sales is rendered showing the gain or the loss, and the result is entered in the journal. The general journal is more commonly used in connection with such entries.

Assume that the sale by A was made at 69 1/2, thereby realizing a gross profit of \$100. The entry would appear as follows:

Debit Long & Barnett....	\$96.25
Credit Customer A.....	92.50
Credit Grain Commission..	3.75

A statement of the trade would be received from Long & Barnett, attesting to the accuracy of the settlement, and in their contract account the sale would be reflected as though a purchase had been made by them of 5,000 May corn at 69 1/2.

The same procedure is followed in other grain and provision settlements.

No "point balance" is necessary, owing to the fact that the unliquidated contracts carried by the resident broker are confirmed at the close of each month, showing the quantity and price of all open commitments. The accuracy of the settled options is verified by the account sales received during the period.

On the "Income Statement" the commission realized from Chicago business is treated as income from operation.

CHAPTER XXX

COTTONSEED-OIL AND COFFEE BROKERAGE

COTTONSEED-OIL BROKERAGE

The New York Produce Exchange is the world's market for cottonseed-oil and its by-products. A contract in cottonseed-oil contains 100 barrels of 400 pounds each, or in the aggregate 40,000 pounds. Prices are quoted in cents and one-hundredths of a cent per pound. A fluctuation of $1/100$ is known as a point. A point equals \$4 on each contract. The commission is \$15 to non-members for the purchase and sale—\$7.50 either way. The Clearing Association, discussed in Chapter XXVII, attends to the settlement of all transactions. The same methods are employed in the settlement of oil as in clearing grain contracts.

Original margin is demanded on purchases or sales. The requirements are \$1.50 per barrel, long or short, and 50 cents per barrel on "spreads." As between non-associate members, original and market margins are required in the customary way. The same holds true wherever an associate member has dealings with a broker without such connection.

The losses and gains of customers, arising out of oil transactions, are recorded in an account known as "Contract Differences—Oil."

All payments and receipts from the Association are charged and credited to the account of "Contract Differences—Oil—Clearing House."

The "point balance" operated in the cotton business could be employed with equally good results in verifying the balance appearing in the Contract Differences—Oil account.

The commission which is earned as a result of the trans-

actions in cottonseed-oil constitutes primary income and is to be treated in that manner on the "Income Statement."

COFFEE BROKERAGE

In rounding out the subject of brokerage accounting, the business of the "Coffee Futures" market will be discussed briefly.

One contract in coffee is 250 bags, each bag being of the approximate weight of 130 pounds. The contract, therefore, contains 32,500 pounds. The price is quoted in cents and hundredths of a cent per pound. One one-hundredth is known as a point. A fluctuation of one point equals \$3.25 on the contract. The commission to non-members is \$20 on the complete transaction—purchase and sale.

The majority of the produce concerns have memberships on the Exchange. No additional books of account are necessary in the accounting department to record transactions in coffee. The only additional "Street" records required are a Street ledger and margin book.

As the Coffee Exchange conducts no clearing house, all contracts are usually carried until "tender" day, at which time they are settled.

Under such conditions it becomes necessary for brokers to call each other for original and market margins, thereby protecting themselves against loss. The original margin requirements are \$1 on each bag, or \$250 on the contract. All margin checks are made payable to one of the designated banks, and are deposited with the Secretary of the Exchange.

From the standpoint of the customer, the usual margin is \$500 per contract. As the market in coffee is subject to great fluctuation, this margin is considered conservative.

The commission resulting from coffee transactions is credited to a separate commission account, but is included as primary income on the statement of income.

Part IV—Brokerage Auditing

CHAPTER XXXI

AUDIT OF STOCK BROKERAGE BOOKS

Purposes of Audit

The auditing of stock brokers' books is a new departure for the accountant. While, by reason of the technical knowledge which such an undertaking imposes, very little can be accomplished without a thorough knowledge of Wall Street technique, the accountant must recognize that there is as much need for an audit of the "Street's" records as there is for the examination of records in any other line of commercial endeavor.

At this point the following extract from the report of Governor Hughes' Committee on Speculation in Securities and Commodities (1909) will be of interest as indicating the position of the Hughes' Commission on periodic audits:

"Failures and examination of books: The advisability of requiring by State authority an examination of the books of all members of the Exchange analogous to that required of banks, is urged upon us. Doubtless some failures would be prevented by such a system rigidly in force, although bank failures do occur in spite of the scrutiny of examiners. Yet the relations between brokers and their customers are of so confidential a nature that we do not recommend an examination of their books by any public authority. The books and accounts of members of the Exchange should, however, be subjected to a periodical examination and inspection pursuant to rules and regulations to be prescribed

by the Exchange, and the result should be promptly reported to the Governors thereof."

Granting, then, the necessity for periodic examinations of the brokers' books, what should an audit of brokerage records show? Ordinarily, it should result in a report by the accountant, commenting upon the financial condition of the client, passing upon the correctness of the financial statements, and construing such of the financial reports as focus the operations of the period under review. Robert H. Montgomery* gives the general purposes of an audit as follows:

"To ascertain the actual financial condition and earnings of an enterprise for:

- (a) Its proprietors (partners or stockholders).
- (b) Its executives (managers, officers, or directors).
- (c) Bankers or investors
- (d) Bankers who are considering the discounting or purchasing of its promissory notes."

and to detect:

"Errors of principle
Clerical errors
Errors of omission
Errors of commission
Offsetting errors"

With the purposes of an audit thus well defined, let us consider the usefulness of such an examination to the broker. First, it will serve his interest by giving him a comprehensive and intelligent statement of his business, its earnings and financial status. Second, it will help him in the future administrative conduct of his business. Third,

*In "Auditing, Theory and Practice," pages 10, 15.

the result of an audit will help him materially in procuring better banking consideration.

Also, it may be said that there is a satisfaction to be enjoyed in the knowledge which an audit gives, that no irregularities are occurring. In the brokerage business the possibilities of speculation are great. "Money" is the only commodity handled, and when this is considered there should be no doubt as to the expediency of periodic inspections by a competent person, or as to the value of a statement from him certifying to the condition of the business and to the correctness of its operations.

Before proceeding further, the point should be emphasized that an audit, whether made at the instance of an Exchange, a partner, or a customer, should not be superficial; it should be intensely scrutinizing. More than once have accounts been passed over whose very construction should have elicited profound questioning by the auditor. The accounts spread upon the broker's books are too crowded with values to allow of a perfunctory handling.

Scope of Audit

The scope of a Wall Street audit is the next important matter. What does it call for? Is it to be a periodic audit? Is it to be a thorough examination, or an inspection of one particular account? What should the audit of the securities department embrace? The answer to these questions will depend somewhat upon the nature of the business—whether it is a Stock Exchange concern or a commodity broker. The following outline of audit requirements calls for a thorough examination of a concern with memberships on all the important Exchanges.

Such an audit should embrace:

1. The verification of cash—petty and general.

2. The proof of correctness for stock accounts receivable, long of securities.
3. The verification of accounts receivable having no equity in securities, but representing for the most part credit advances to customers for the purpose of investment and speculation—open debits which are considered perfectly collectible.
4. The examination of notes receivable lodged with the broker.
5. The ascertainment of the sufficiency of margins on all commitments in the market.
6. The physical examination of securities in the broker's possession representing the purchases of customers on a marginal basis.
7. The physical examination of securities which the broker is holding for safe-keeping for his customers.
8. The confirmation with brokers in the Street of any loans made on collateral by the client, paying especial attention to the nature and adequacy of the collateral in the loan, the interest rates, and the duration of the loan—whether on time or demand—and if on time, whether for 30 or 60 days, or for a longer period.
9. The examination of securities owned by the broker and the place of deposit.
10. The depreciation of such securities.
11. The item of "Furniture and Fixtures," with particular attention to the matter of depreciation and whether any capital assets of this class have been charged to income. This error when committed is usually due to the laxity of affairs and the total ignoring of proper accounting principles.
12. As many brokers also do a banking business, they

frequently have their own buildings, upon which taxes are payable and upon which depreciation and reserves are to be allowed for.

13. The item of stocks borrowed against short sales is important enough to warrant the confirmation of the lender, thereby verifying the number of shares, the description of the security, and the price and rate at which borrowed.
14. Dividends which have been or are to be received on long stocks should receive the attention of the auditor.
15. The treatment of dividends in the event of an "even interest" in the stock; that is, where some accounts are long and others short of the same security during dividend time.
16. In connection with dividends, the consideration of due bills receivable to corroborate the right to dividends whose payments are pending.

The foregoing relate to the asset section of the balance sheet. On the liability side the audit should embrace:

1. Accounts payable representing:
 - (a) Open credit balances, in which, however, the accounts have no further equity by reason of "long" securities.
 - (b) Open balances, when the accounts also include holdings of stocks or bonds.
2. Verification of accounts payable whose equity is subject to the purchase or "cover" of short securities.
3. Certification of the correctness of the Notes Payable account.
4. Verification of dividends payable, whether arising from borrowed stock, or from certificates having

remained in the client's name after the date of sale. In connection with this is the Due Bill account attesting to the liability of dividend payment by the client.

5. The examination of Stocks Loaned account, covering the name of the borrower, the number of shares, description of issue, and the price and rate at which the loan stands.
6. The confirmation with the lending bank or broker of any money borrowed on collateral by the client, at the same time corroborating the amount of the loan, its duration, the collateral contained therein, and the rate of interest.

The third list of audit requirements concerns itself mainly with the economic or income statement accounts. For this it is necessary:

1. To examine into the adequacy of reserves which might be created to provide for depreciations and doubtful accounts, directing such adjusting entries to be made as seem necessary or consistent with the policy of the client whose books are being examined.
2. To verify the Commission account, which will present no little hardship, for here it will become necessary to check the individual credits and debits from the blotters—clearing house and ex-clearing house.
3. To verify the interest on customers' accounts.
4. To verify the interest debits or credits on account of stocks loaned or borrowed.
5. To verify the premiums on stocks loaned or borrowed.

6. To confirm with the lender or borrower the interest on money borrowed or loaned.
7. To examine into the apportionment over the period of membership dues usually paid in advance.
8. To examine into other deferred debit items, such as insurance on building, taxes, etc.

Finally, the capital accounts of the partners, and the just distribution of profits and losses according to the articles of copartnership, will claim the attention of the auditor in charge of the examination.

CHAPTER XXXII

AUDIT OF STOCK BROKERAGE BOOKS ASSET ACCOUNTS

While the audit outline of the preceding chapter is fairly comprehensive, there is a probability of an even greater number of factors being found in any particular audit which should command careful consideration. For instance, there may be a substitution of securities while the securities accounts are being inspected, or a sale of certain securities while the auditor is working on the account in which they are entered. Such possibilities must be recognized and provided for, as it is obvious that if once the control of securities is lost, the continuance of the examination becomes absurd.

In the present consideration it is not intended to lay down any hard and fixed rules of procedure, but only to suggest the method of verifying unusual items and to call attention to those other features of the audit which require more careful scrutiny or special procedure.

Stock Accounts Receivable

Unlike the mercantile business where almost every entry grows out of the purchase, sale, or return of merchandise, and where a charge to a customer's account presupposes such a transaction, the accounts receivable of stock houses may represent many things. They may show purchases of stocks still long, balances without equity to the customer, or mere advances to the trader for one reason or another.

The only sources of entries to the customers ledgers

are the blotters. Consequently, the blotters may be looked to and depended upon to reveal a complete history of the transactions appearing in the accounts receivable. Having by this means established the regularity and the nature of the particular account under review, we must admit such possibilities as may require further proof of the regularity and correctness of any particular account. Is it identified by a number instead of a name? Or does it bear a misleading letter? In either case the rule to be adopted is the authentication of the account by the client or by some person in authority. There need be no cause for immediate alarm when a numbered or lettered account is met, for in no other business, perhaps, are the accounts of large customers more sacredly guarded. Nor is there anywhere greater need for a positive verification of accounts receivable than here. Much collusion can be practiced by clerks through the operation of fictitious accounts—a fact that, some years since, was brought out very forcibly by the testimony of a member of a certain Exchange, whose concern carried the account of a prominent executive at Albany.

In any event, the auditor should insist upon a statement from his client to the effect that all such numbered accounts are known to him. Also the identity of the customer should be made known to the auditor, whereupon the usual letter of the client should accompany the auditor's request for verification of balances and securities as appearing upon the statement of the customer. At the same time, the number of shares, the description of the securities, the balances against or in favor of the customer, should be recorded on a separate statement for the auditor's benefit; or else the statement of the customer should be copied in a press book for the auditor's benefit before being mailed to the customer. Invariably the customer will respond very

promptly, for it is much to his interest to answer all communications of auditors engaged in an examination of his broker's books. This is particularly true of margin customers.

If still further scrutiny is desirable, the auditor may go to the length of procuring the client's authentication of all signatures subscribed to the returned letters of confirmation. On the other hand, if any of the customers fail to reply, then the client should be apprised of the fact in the report rendered at the close of the examination.

Under stock accounts receivable, another salient feature should be noted, namely, the sufficiency of margins. As has been pointed out under the subject of equity tables, a customer's account may be approaching the danger mark as far as his margins are concerned. Again, there may not be a vestige of margin left in the account, so that the difference between the ledger debit and the market value of the securities held by the customer leans towards "a minus equity" to the customer after sale. Here, the nature of the account would change from a stock account receivable to an ordinary doubtful or uncollectible account receivable. The importance of this point can be readily seen by referring to the case of the customer who, having a credit extended to him, had an open loss of \$25,000 on a purchase of 5,000 Steel.

In conclusion, it may be said that a general classification should be made of the various stock receivable accounts, grouping credit customers, margins accounts, minus equity accounts, and doubtful accounts containing no securities.

The Revenue Stamps Account

The Revenue Stamps account is nothing more than an inventory account. It records the purchase of stamps on the debit side and the consumption figure on the credit

side, these representing the use of the stamps on account of sales or transfers. The balance figures should agree with those resulting from a physical inventory taken by the auditor.

The item of revenue stamps is an important one, requiring keen inspection.

Securities of Customers

Whether the customer is long or short of securities, every single share of stock as recorded by the securities ledger should be traceable to its place of deposit.

If John Brown, for instance, is long of 100 shares of Copper, they should be in one of four places, i.e., in the vault, in the transfer office, in a stock loan, or in a collateral loan with some bank or broker. Their position should be confirmed by physical examination if in the vault, or by letter if at the transfer office or in either stock loan or collateral loan.

Or, if John Brown is short of 100 Steel, they should be accounted for in one of two ways, i.e., they may be borrowed—in which case the auditor should confirm the borrowing of the shares by communicating with the lender thereof—or it may be that 100 shares of Steel long by another customer have been used to make delivery against the short. It should be remembered that the broker may use long securities only with the customer's permission.

Wherever possible, in all cases involving such securities a thorough examination of the certificates of stock should be made, taking note of the serial number in each instance. If the auditor be engaged in verifying securities, and occasion should arise for the broker to use a particular certificate of stock, then the serial number should again be taken and a notation made accounting for this certificate in one of the following ways:

1. Sale.
2. Pledged as collateral in a loan.
3. Lent out in the Street.
4. At the transfer office for re-registration.
5. At the bank for purposes of substitution, that is, to
 be exchanged for such securities as might be necessary for delivery against a sale.

In the last case the certificates which were received in return should be taken care of in accounting for their position.

Bonds are either registered or coupon in character. In examining coupon bonds, it should be noted that all coupons are intact, and any irregularities should be commented upon. For example, if a bond bearing January and July coupons be examined in June, it should bear the coupon of July of the same year and all others until maturity.

While considering coupon bonds, the necessity of determining whether all coupons have been placed to the credit of the account owning the bonds becomes very patent. Coupons, while they are negotiable (being bearer instruments), are nevertheless subject to a collection rule which most banks have laid down—namely, that all coupons must be enclosed in an envelope bearing the name of the depositor and that of the corporation by which the coupons are payable. Consequently, some supervision is possible along these lines.

Registered bondholders receive interest checks direct from the paying company. Here too, a watchful eye must be given to the payments of interest during the period, or those pending between the commencement of the examination and the completion thereof. In the matter of registered bonds, the serial number should be recorded, and it should be noted that the bond is negotiable in nature.

Depreciation of Securities Owned

Securities may be held for investment by the client, i.e., the broker for whom the audit is made. In such cases the tendency is to carry securities at cost, but conservatism and good accounting principles dictate the practice of taking cognizance of any variance in values, particularly so if such values show a depreciation. As the auditor is employed to examine books and not to criticise methods or policies of his client, he can hardly do more than make the subject of depreciation of values an item in his report. Needless to say, if he be requested to adjust values, he should not overlook this important account.

Money Loaned Account

It is not an uncommon practice for brokers to lend money in the "loan crowd" of the Exchange. The loan, having thus been created, is subject to examination by the auditor and should be confirmed by the borrower as to the collateral contained therein, the amount of the loan, the rate of interest, and the duration. Inasmuch as the loan envelope will be available for inspection, this should be taken advantage of to substantiate the record appearing in the "Money Loaned Book," which is further supported by the account in the general ledger bearing the same caption. The adequacy of margin should be investigated, and in the event of insufficiency should be brought to the notice of the client. On liquidated loans, the auditor should test the correctness of the interest.

There is much to be said about call loans, inasmuch as the interest rate is variable, and it behooves the auditor to check not only the prevailing rate of interest but also the changes from the day the loan was made up to the present period. Since the lender is only pledgee for the securities, he may only hold them as a pledge and not use

them for any purpose. If he does, such use may render him liable to a charge of conversion. For this reason, the whereabouts and use of such securities should be carefully investigated and immediate attention be called to any irregularities discovered.

On time loans the same general procedure is to be followed, the only difference being in the interest payments. This will be touched upon in Chapter XXXIII.

Furniture and Fixtures

It is almost a fixed rule among brokers to charge the cost of furniture and fixtures to income. In practice one meets this condition constantly. In principle the method is very wrong, indeed.

In such cases it will devolve upon the auditor to explain that an account should be set up with furniture and fixtures, showing the purchase price, which in reality amounts to many thousands of dollars. When this account is found, the auditor upon questioning will usually be told that a nominal rate of 10% is annually charged off on account of depreciation. If no reserve for such depreciation has been set aside, the practice should be advocated. Usually it will be found that the broker is either too conservative in his accounting allowances or too liberal. The tendency, very regrettably, leans strongly towards carelessness.

Land and Buildings

A few of the larger brokerage concerns occupy entire buildings for their business use. They may own or lease these buildings. Where owned, the necessity of depreciation should again be emphasized. Also the items of taxes and insurance should be intelligently accounted for, apportioning the insurance over the period and making due allowance for the accruing taxes.

Stocks Borrowed

The subject of "stocks borrowed" has been discussed in connection with short sales of customers. But for auditing purposes it should be treated under a separate heading.

Stocks borrowed are equivalent to money loaned. However, the constant marking up and marking down of values while the stock is borrowed presents no little task to the auditor, who must consider the various changes that have taken place since the particular stock was borrowed. All such changes in value and interest rates should be listed and the listing be made the contents of a letter of confirmation to be sent to the lending broker.

Dividends Receivable

Among other items of importance to the auditor is that of dividends. The Dividends Receivable account should show the shares of stock upon which dividends have been, or are to be, received. In proving the correctness of this account, the stock ledger should be consulted for information in regard to the long stocks upon which dividends are due. A record should be compiled of the purchases and sales of all dividend-bearing stocks within the period, closely watching for sales and purchases before dividend declaration time. By checking the open "longs" with the Dow Jones Dividend List or any other official dividend indicator, the charges in the Dividends Receivable account can be proved.

Credits may appear in this account, with complementary entries to the Due Bills Receivable account. In that case it is evident that the stock upon which the dividend is to be paid was sold after declaration day, but before the day of payment. In the event of due bills, they should be carefully examined and confirmed by the broker issuing same.

As a last factor in proving Dividends Receivable account,

it should be recalled that the sale of short stocks of a similar class might prevent the appearance of an entry in either "Dividends" account or Due Bills account. This is so by reason of the offset appearing in the ex-blotter, and attesting to the fact that the "long" customer was credited with the dividends and the "short" customer charged therewith. It is obvious that this situation precludes the possibility of a dividend being received if the certificate was transferred by the buying broker at the time delivery was made by the client broker against the short sale of his customer. The point is mentioned here merely to put the accountant on guard should he meet such a condition. Of course, it must be borne in mind that the client may receive dividends on stock in which he has no "net interest," due to the fact that the buyer could not or did not transfer the certificates in time to receive the dividend check direct from the corporation.

Having compiled such information as can be used to check the entries in the Dividends Receivable account, the auditor should proceed with the checking of dividend credits appearing in the customers' accounts. In this connection it should be remembered that the practice in some concerns is to credit the customer's account without the operation of the Dividends Receivable account, and among other brokerage houses a practice is made of crediting the customer upon declaration day rather than on the payment day. If the important facts be kept in mind, little difficulty should be experienced in auditing "dividends."

CHAPTER XXXIII

AUDIT OF STOCK BROKERAGE BOOKS LIABILITY ACCOUNTS; INCOME ITEMS

LIABILITY ACCOUNTS

Accounts Payable

The only accounts payable usually found in the audit of a broker's books are in the nature of "short" accounts and open credit balances having no securities. There may be one or two accounts which, besides having such balances, are also long of securities that for the most part can be traced to the safe deposit box.

The procedure here is to check the transactions appearing within the period covered, with the blotters and securities ledger. If interest be allowed on open credit accounts, its amount should be tested. The appearance of interest other than that allowed on margins on short accounts should provoke inquiry as to the regularity of the interest credit. The general rule is not to allow interest save on "short" margins, unless a special arrangement therefor be made with the customer.

In the matter of short accounts, the same procedure as obtained in long accounts receivable should be followed in determining the adequacy of margins on the open commitments. In both accounts receivable and payable, where an interest in the market is evidenced by the records, the auditor should inquire as to the classification of accounts; that is, whether the customer is trading on a credit extension or whether he is operating on margin. This distinction

is an important one, particularly so if the auditor's report is to be used for the purpose of securing banking favors.

Approaching the subject of short accounts from the angle of "stocks borrowed," it is important to determine whether the short stock is borrowed in the Street or from a customer. Under the present law it is conversion to borrow stocks from long customers in order to make delivery against short sales, unless the long customer has signed a waiver giving the broker the right of hypothecation for the amount in excess of the balance owed by the customer.

Dividends Payable

It has already been pointed out that the Dividends Payable account is created:

1. Where stock sold before dividend declaration day remains in the client's name until after a dividend has been declared. In such cases, upon receipt of the dividend check, the Dividends Payable account should be credited until the dividend is claimed by the broker holding the certificate of stock.
2. Where a dividend is declared on short stock which has been borrowed from the Street. In such case the customer's account is charged and the Dividends Payable account is credited, being charged only after a due bill is sent to the lending broker. Under that circumstance the Due Bills Payable account would attest the liability.

The further procedure in verification of dividends payable is similar to that prescribed for dividends receivable in the preceding chapter.

Stocks Loaned

The procedure in auditing the Stocks Loaned account is identical with that prescribed for the verification of stocks borrowed.

Bank Loans and Brokers' Loans

In the audit of loans from banks and brokers, it is necessary to get the lender's confirmation of the collateral contained in the loan; also of the amount, the rate of interest, and the sufficiency of collateral. If it be a demand loan, the daily interest changes should also be noted in the letter of confirmation. In the case of a time loan, the duration should be stated, together with the interest accrued thus far. The agreement with the lender may call for the interest to be paid in advance, monthly or at the liquidation of the loan. All such data should be availed of wherever possible.

INCOME ITEMS

Commissions

As was pointed out in Chapter XIV, the commissions of the securities department may arise from two sources:

1. The execution of orders for customers.
2. The execution of orders for other members of the same Exchange, either for "carrying" transactions, "clearances," or "give up" business.

The charges against the Commission account result from:

1. Floor brokerage due to brokers for the execution of orders.
2. Commission owing to other brokerage concerns which may be carrying the client's commitments for him.
3. Commission charged on clearances.

All charges and credits to the Commission account should be tested by reference to the blotter containing such entries, and by the compilation from the purchases and sales book of a statement of orders executed by other floor brokers. The credits to this account arising out of the execution of orders for other concerns, can be traced to the record from which the monthly commission bills are made out. This last record should be carefully scrutinized. If these bills have not been paid, as evidenced by the books, written confirmations should be secured from the respective brokers for the purpose of verifying those outstanding items of which no previous cognizance had been taken.

Interest Charges and Credits on Customers' Accounts

Some customers ledgers are so ruled as to give the number of days for which interest is to be charged or credited, and the individual interest amounts are carried into an interest column. The net difference between the charges and credits is then passed through the ex-blotter for journalization, and debited to the customers' accounts in the usual manner.

This arrangement is ideal but is seldom met. The general rule is to make interest calculations on the statement, of which a press copy is made. The net amount of interest to be charged or allowed is entered net to the customer. Wherever this system prevails, use should be made of the press-copy books to test the interest debits and credits.

The auditor will also meet cases where no press copies are made. In that event it would be safe to test the interest on each transaction appearing in the accounts. Under the rule of the Exchange, it is in violation of the commission law to rebate interest. Wherever such rebates are discovered, they should be called to the attention of the client

so that proper adjustment may be made if possible or a recurrence prevented.

In the discussion of accounts payable in the present chapter, it was intimated that accounts payable with open credits seldom benefit by interest credits. The method of procedure suggested there could be followed to good advantage in the general investigation of interest charges.

Interest on Stock Loans and Premiums

Exacting methods should be adopted in proving the interest and premiums on stocks borrowed and loaned. The stocks borrowed and loaned book offers the best foundation upon which to build the interest accounts. On clearing house stock returned or called, recourse should be had to the clearing house blotter containing the record of the transaction. The interest should be thoroughly tested.

The premiums appearing in the premium accounts should be examined in like manner. The rule of the Exchange should be remembered, that premiums are not to be charged for Saturdays, Sundays, and holidays.

Where interest or premiums have accrued or are accruing, a confirmation should be sent to the broker on the other side of the transaction. This procedure will disclose any error or irregularity.

Expense Items

Expenditures are to be verified in the usual manner. As a suggestion, however, it would be well to get a statement from the client as to what expenditures are consistent or customary to the business. All vouchers should be examined carefully, and especially those concerned with the expenses of branch offices and solicitors.

Final Procedure

The auditor should examine the table of equities, being

especially careful as to accounts with minus equities and accounts nearing the margin-exhaust point.

The system obtaining in the concern under audit should not be attacked unnecessarily, for the very good reason that unsolicited information is undesirable in the vast majority of cases. Of course, it behooves the auditor to point out where losses and leakages could be prevented, but beyond that it would be indiscreet to submit a dissertation on the relative weakness of the system or the morale of the office staff.

As a final word in the audit of the stock brokerage business, the auditor should bear in mind that the report is more comprehensible to the client if the technical terms be used. It is a fact that the broker thinks and speaks in the parlance of the Street, and any other accounting terminology is as foreign to him as his vernacular is to the layman.

CHAPTER XXXIV

AUDIT OF COTTON BROKERAGE BOOKS

Outline of Audit

The audit of cotton brokerage books will require the verification or confirmation of:

1. Petty and general cash.
2. Accounts receivable representing open debit balances of credit customers and of marginal accounts, both having no interest in the market.
3. Accounts receivable which have commitments open showing gains large enough to offset their ledger balances.
4. Accounts receivable, mainly credit accounts, whose open transactions show market losses, thereby augmenting the ledger debit.
5. Accounts receivable against which spot cotton warehouse certificates are held, thereby creating equities in favor of the customer.
6. Notes receivable.
7. Street margins deposited by the client.
8. Agreements between the client and other houses to give checks as margins, instead of depositing with the Superintendent of the Exchange in the usual way.
9. Contracts open for account of customers, stating the date of purchase or sale, the option, and the price.
10. Contract Differences account, debit or credit, involving:
 - (a) Sending confirmations of open trades to customers.
 - (b) Sending confirmations of open trades to **Street** brokers.

- (c) Checking account sales during the period embraced by the audit.
- (d) Checking receipts from, and payments to, the clearing house and ex-clearing house brokers.
- (e) Checking of point balance; this
- (f) Resulting in present balance in Contract Differences.

11. Accounts payable with customers, this being done in the usual way, carefully noticing any numbered or lettered accounts.

12. Adequacy of margins on open commitments of credit customers, seeing that no calls have been overlooked.

13. Sufficiency of margins on the open trades of margin customers.

14. Spot transactions carried on margins—the charges of labor, storage, insurance, and interest always being added to the open debits.

15. Notes discounted.

16. Loans payable, containing collateral in the nature of warehouse certificates:

It is also necessary to—

17. Test thoroughly the Commission account, being careful to include in the examination the verification of commission bills receivable and payable.

18. Test beyond a doubt the correctness of interest on margins released, notes receivable, notes payable, and loans payable.

19. Give the expense factors the same careful scrutiny that was suggested under the securities audit.

20. Finally, investigate the division of profits and losses as per the articles of agreement.

Accounts Receivable

Unless the account be that of a credit customer, there

should exist no customers' accounts receivable on the books of the cotton department, except in the case of a customer having open trades showing a profit large enough to equal or exceed the indebtedness. It is almost conclusive that if any other accounts receivable be discovered, such accounts are to be reserved or written off entirely. It devolves upon the examiner to call the client's attention to such cases whenever they arise.

There is still another set of accounts, mainly to be sought in credit accounts, where a market loss is to be added to the debit balance in the ledger, thereby increasing the indebtedness. If a credit agreement has been entered into between the client and the customer, the fact should be made known to the auditor, for without such knowledge the results of the examination are misleading, the basis for the division of accounts having been disturbed.

Other accounts receivable are fully secured by having as collateral, spot cotton warehouse certificates. In such accounts items of interest, labor, storage, and commission are to be looked for. Storage and interest are charged monthly, while labor and insurance are charged upon expiration of the policy, or, as in the case of labor, when the cotton is moved at the time of sale or shipment.

Street Margins

Verify Street margins deposited by the client, by sending written confirmations to the broker for whose benefit the deposit was made. On margins released within the period, it is incumbent upon the accountant to prove the deposits and releases, paying strict attention to the fact that margins are "up" only when necessary, meaning that the margins so deposited represent either market losses or "original" calls.

On Street margins up by other brokers, as evidenced

by the Street margin record, verification should also be had by the usual letter of confirmation. In this connection it should be noted that there are large concerns in the Street which are not called until a certain sum is owing—a sort of credit comity between the houses. Now, if the auditor should meet such accounts, he should first determine by inquiry whether the house in question is callable within certain limits. Otherwise, as a rule, no broker should owe the client more than \$500 without being called. Accounts which show “no margin up” should be commented upon in the report.

Sometimes it is advisable for houses to exchange checks for the amount owing on open trades, rather than deposit such sums in the usual way. This would allow the use of the funds by the concerns to whom the margins are owing. Before remarking upon the absence of margins “up” by other concerns, it would first be advisable to consult the general ledger with this possibility in mind.

Open Trades of Customers

Statements containing a list of open trades should be sent to each customer for verification, accompanied by the request to return the same to the auditor at once, the purpose of the request being stated.

Verification of the Contract Differences Account

The advices received from customers should form the basis for verification of the Contract Differences account in the general ledger. In connection therewith, it will be necessary to confirm with the brokers in the Street all open trades, giving the number of bales, the options, and prices. The return advices are to be used for purposes of verifying the Contract Differences account in the manner prescribed under the section “Point Balance” (Chapter XXI).

The account sales rendered to the customers should be checked with the purpose of testing proper charges and credits to the Contract Differences account. The receipts and payments made on account of clearing house settlements should be checked to the cash book, which in turn should be tested with the monthly charges and credits in the Contract Differences account.

By setting up the facts as outlined, the point balance will receive not only the usual check, but also that involved in a thorough compilation of all facts entering into the construction of the account under review.

Accounts Payable

The accounts payable with customers represent margins deposited on market commitments. Under the law of the Exchange, no interest may be allowed on deposits of customers' margins. If a violation of this rule be apparent, it should be brought to the attention of the client and be remedied immediately. A statement of each account mailed to the party to whom it is owing, with a request to confirm, will assure a thorough check of the accounts payable. All the account sales should again be checked to the customers' accounts, together with cash receipts and cash disbursements from the check book. Journal entries should also be checked, as they affect the accounts of customers through bank advices. The margins of customers should be looked into, calling attention to any "weak accounts." Always consult the table of equities in regard to margins.

Commissions

Commissions should be checked from the contract analysis journal and from commission bills receivable and payable. The suggestions as to the verification of unpaid bills in the stock brokerage audit may be well adopted here.

Interest on Margins

Interest on brokers' margins should be tested in the following manner :

1. Ascertain the date of deposit and the date of release.
2. Compute the interest for the number of days that the margin was on deposit.

Audit of Other Commodity Departments

The same procedure as outlined for the audit of the cotton department may be used to good advantage in the audit of the produce, grain, cottonseed-oil, and coffee departments. The only difference really arises in the matter of proving the Contract Differences—Clearing House account and the Contract Differences—Oil account. If the verification of the "Point Balance" as outlined in Chapter XXI be followed, no difficulty need be experienced in testing the accuracy of the accounts in discussion.

Part V—Forms

CHAPTER XXXV

STOCK BROKERAGE FORMS

PURCHASES										SALES				
March 1, 1916										March 1, 1916				
OF WHOM PURCHASED	Nº OF SHARES	DESCRIPTION	PRICE	TIME	FOR WHOSE ACCOUNT	WHEN RECD	TO WHOM SOLD	Nº OF SHARES	DESCRIPTION	PRICE	TIME	FOR WHOSE ACCOUNT	WHEN DELD	
Short, J. W.	20	Reading	145	R	J. Dor	3/16	DeBorley Co	25	Steel	65 1/2	503	E. Squires	3/16	
DeBorley Co	30	Copper	65 1/2	R	J. R. R.	3/16	Malon Co	17	Steel	97 1/2	504	J. Stanley	3/16	
							Brooks Co	100	Spain-Rent	182	C	D. Hinson	3/16	

Form 2. Purchases and Sales Book—Ex-Clearing House

<u>Robert Smith</u> <u>Brooklyn, N.Y.</u> <u>Long Account</u>			
NO OF SHARES	NAME OF STOCK	MARKET PRICE	VALUE
100	Union Pacific	165	16500
100	Reading Con	167½	16750
100	Copper	77½	7750
100	M. Central	110	11000
~~~~~			
MARKET VALUE OF STOCKS			52475
DEBIT BALANCE			48700
100	SHARES	MARGIN	3675
No of points Margin ... 8			

Form 7. Margin Card, showing an account long of the market

<u>John Brown</u> <u>Schenectady, N.Y.</u> <u>Short Account</u>			
NO OF SHARES	NAME OF STOCK	MARKET PRICE	VALUE
800	Am. Ice Sec.	27	21600
~~~~~			
COVER VALUE OF STOCKS			25600
CREDIT BALANCE			30000
800	SHARES	MARGIN	8400
No of points Margin ... 6			

Form 8. Margin Card, showing an account short of the market

CLEARING HOUSE OF THE NEW YORK STOCK EXCHANGE							No. <u>35</u>		
New York, <u>Jan. 3, 1916</u>		Office Address <u>927 William St.</u>		Sheet of <u>X-60</u>					
RECEIVE FROM	SHARES	STOCK	PRICE	AMOUNT	DELIVER TO	SHARES	STOCK	PRICE	AMOUNT
J. Moore & Co	100	✓ Copper	76 $\frac{7}{8}$	7675	Redman & Co	200	✓ Smelters	70 $\frac{1}{2}$	14050
James Wallace	100	✓ Steel-com	66 $\frac{5}{8}$	6662.50	C. M. Short & Co	100	✓ Wm. Bee.	162	16200
E. J. Norton & Co	100	✓ Smelters	69 $\frac{1}{8}$	6912.50					
Balance to deliver	100	✓ Smelters	70	7000	Balance to receive	100	✓ Copper	77	7700
	100	✓ Wm. Bee.	162	16200		100	✓ Steel-com	67	6700
Draft	500			200					
				44650		500			44650
Enter on this sheet only those transactions for which Tickets have been exchanged. The Tickets must agree or both parties will be fined.									

STOCK BROKERAGE

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TO RECEIVE

January 3rd - 1916

OF WHOM BOUGHT	Nº OF SHARES	DESCRIPTION	PRICE	AMOUNT	COM-MISSION	INTER-EST	TOTAL AMOUNT	FOR WHOSE ACCOUNT	NUM-BERS
J Moore & Co	100	✓ Copper	76 ³ / ₄	7675	12 ¹ / ₂		768750	John Jones	
James Wallace	100	✓ Steel	66 ³ / ₈	661250	12 ¹ / ₂		662500	Fred Smith	
E & Kinton & Co	100	✓ Steel	67 ¹ / ₈	671250	12 ¹ / ₂		672500	R. S. S. S.	
Clearing House:					27 ¹ / ₂				
Balance, to Debit	100	✓ Steel	70	7000				Clearing House	
Clearing House Draft	100	✓ Union Pac	162	16200				"	
	500 ✓			2700			234000	"	
				446500 ✓			446500 ✓	"	

Form 14a. Clearing House Blotter (left), showing methods of balancing

TO RECEIVE	OF WHOM BOUGHT	Nº OF SHARES	DESCRIPTION	PRICE	AMOUNT	COM-MISSION	INTER-EST	TOTAL AMOUNT	FOR WHOSE ACCOUNT	NUM-BERS
			<i>C. Bissell</i>		50000					
			<i>D. J. Hand</i>		100000					
		100 ~~74~~	<i>Un. Gas. 1st A's</i>							
		50 ~~74~~	<i>Steel & F. 51</i>							
		50 ~~74~~	<i>do. Pac. Rly. 4's</i>							
			<i>Balance</i>		240000			150000		
								150000	<i>Manhattan Bank</i>	

Form 15a. Ex-Clearing House Blotter (left), showing transactions at time of inception of business, without a record of purchases or sales

STOCK BROKERAGE

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TO RECEIVE

January 5, 1916

OF WHOM BOUGHT	Nº OF SHARES	DESCRIPTION	PRICE	AMOUNT	COM- MISSION	INTER- EST	TOTAL AMOUNT	FOR WHOSE ACCOUNT	NUM- BERS
Hamlin & Co	✓ 100	Copper	77	77.00			144.00	Clearing House Ac ^t	B 311
W. E. Brecher	✓ 100	Steel	67	67.00				" "	C 65820
Carlton Melnick & Co	10	✓ Am. Can. fr.	91	91.0	125		91.125	E. A. Blancy	B 138
De Coplay & Co	30	✓ Copper	70	21.00	375		21.0375	E. P. Orlando	NY 9112
	✓ 10	✓ Wm. Briggs	13.12					E. Daniels	11512
		W. C. Mottor & Co					100.000	Money loaned %	
		(money loaned to above)					75.79675	Manufacture Co. Bk	
		Balanced					492.111.75		

Form 16a. Ex-Clearing House Blotter (left), showing treatment of clearing house balances (see Form 14)

TO DELIVER										
TO WHOM SOLD	NO OF SHARES	DESCRIPTION	PRICE	AMOUNT	COMMISSION	INTEREST	TAX	TOTAL AMOUNT	FOR WHOSE ACCOUNT	NUMBERS
E. B. Randolph	100	Balance						15000	Manhattan Co Bank	
Johnson & Co	100	✓ Amalgamated	70	7000					Clearing House %	10 314
	100	✓ Union Pac	162	16200					" "	1349
		✓ Graft. Co. House		200				23400	" "	
E. M. Short & Co	10	✓ Union Pac.	164	1640	125		20	16385	E. Daniels	11512
J. C. Jackson & Co	25	✓ U. S. S.	94	2375	312		50	2475	A. Grafton	10 314
		back						2500	J. Jones	
		"						1000	W. Smith	
		"						1000	R. Ross	
		"						4000	J. Rich	
		"						100	E. A. Clancy	
		"						250	A. Grafton	
		"						210375	E. P. Delano	NY 9112
		" 30 Copper						67125	(Transfer Stock Register)	6 311
		" 100 "						165	Commission	
								20	Revenue Stamp %	
								19271125		

Form 16b. Ex-Clearing House Blotter (right), showing treatment of clearing house balances (see Form 14)

[illegible]

Form 17. Customer's Monthly Statement—Account of John Jones—Settled Transactions

John Jones					
1916					
Jan. 3	100 Un. Pac. 168	16812.50	Jan. 10	100 Un. Pac. 169 $\frac{3}{8}$	16923 -
10	Interest - 6%	1961			
	Balance	9089			
		16923			16923
			Jan. 10	Balance %R.	9089

Form 20. Customer's Ledger Account—John Jones—Settled Transactions

John Jones, Long %							
1916							
Jan	3	100 Un. Pac. 168	16812.50	Jan	3	Margin Deposit	1000
	16	100 Copper 68	6812.50		10	100 Union Pac ¹⁶⁹ / ₈	16923
	31	Int. @ 6%+2%	32.33		31	Balance	5734.33
			23657.33				23657.33
Jan	31	Balance %R	5734.33				
		Long 100 Copper					

Form 21. Customer's Ledger Account—John Jones—Long

Henry Brown "Short %"					
1916					
Jan. 31	Balance	17924.06	Jan. 10	100 Un. Pac. 169 $\frac{3}{8}$	16923
				Check - Margin	1000
			31	Interest @ 2%	1.06
		17924.06			17924.06
			Jan. 31	Balance %R	17924.06
				Short 100 Un. Pac.	

Form 22. Customer's Ledger Account—Henry Brown—Short

NAME OF ACCOUNT	LEDGER BALANCE		LONG		SHORT		MARKET PRICE	MARKET VALUE	EQUITY	
	Debit	Credit	Shares	Description	Shares	Description			Debit	Credit
Adams, John	14700		100	Un. Pac.			161	16100		14600
Brown, David *	3500								3500	
First Nat'l Bank	80000								80000	
	\$ 98200									
Money borrowed		25000	50	Reading			166	8300		
(Chase Nat'l Bank)			100	Un. Pac.			161	16100		
(" " ")			100	Copper			76	7600	7000	
Bowell, Chas		7600			100	Steel	66			1600
Nelson, Fred		1500								1500
Eagan, Patrick		15800	17 1/2	Steel & 3 5°			103	10300		
"					100	Un. Pac.	161	16100		730
A's Capital		20300							\$ 90500	4630
B's "		15000								85370
C's "		13000							\$ 90500	90500
		\$ 98200								
* Account considered "good"										

Form 24. Equity Table or Statement of Margins

CHAPTER XXXVI
COTTON BROKERAGE FORMS

December 1915											
				GENERAL				SPECIAL			
				Debit		Credit		SUNDY BANKS		CUSTOMERS	
		FOL.						Debit		Credit	
2.											
Natl. Bank of Sumter		✓						500			
To Fred Jones		✓								500	
(Upon receipt of wire advice from above bank)											
3											
L. M. Hoffman		✓		2.50							
To Collection Expense		✓				250					
1/10 of 1% on \$2500-Chicago check											
back in Sundry Banks		✓						1000			
(Natl. Bank of Sumter)											
To G. Whitley		✓								1000	
(Upon receipt of wire from above bank)											

Form 29. General Journal

CASH RECEIPTS									
DATE	EXPLANATORY	NET CASH	EXCHANGE AND COLLECTION	CONTRACT DIFFERENCES	STREET MARGINS	INTEREST ON MARGINS	FOLIO	CUSTOMER'S CONTROL ACCOUNT	GENERAL LEDGER
Dec 1 1915	Balance	50121.10					✓		50121.10
3	Math. Bank Sumter - Draft	500					✓		500
	Cash Sundry Banks (Sumter Natl)	1000					✓		1000
	Contract Differences (El. House Draft)	1810		1810					
5	John Morgan - Cashier's Check	19990					C.L. 310	500	
10	Street Margins - McFarland & Co	10000.81	10		10000	81	M.C. 57		
31	Contract Differences - El. House Draft	20	-	20	1000				
	Cash Receipts	504721.81					✓		
		504721.81	10	1000	10000	81		500	504721.81
Dec 31	Balance	34558.81	✓	✓	✓	✓	✓	✓	34558.81

Form 30a. Cash Book—Receipts

CASH DISBURSEMENTS

DATE	EXPLANATORY	NET CASH	CONTRACT DIFFERENCES	STREET MARGINS	GENERAL EXPENSE	SUNDY EXPENSE	FOLIO	CUSTOMERS CONTROL ACCOUNT	GENERAL LEDGER
1915									
Dec 2	H. K. Jones - Check	11.15					C. 2	11.15	
3	General Expense - Rent	27.5			27.5		17		
4	Contract Differences - 1st House, check	200.5	200.5				m. 2		
7	Street Margins - M. S. Garland & Co.	1800.0		1800.0			50		
10	Petty Cash - Sundries	1.8				1.8	✓		
	Furniture & Pictures - (Book)	50					✓		50
31	Disbursements	2046.3							
	Balance	34253.81							
		51721.81	200.5	1800.0	27.5	1.8		11.15	50

Mr. <u>G. Whitley</u> CHAS. FAIRFIELD & CO 927 William Street				New York <u>Jan. 30</u> 19 <u>16</u>			
DATE 1916	EXPLANATORY	a/c Sales No.	DEBIT	DATE 1915	EXPLANATORY	a/c Sales No.	CREDIT
Jan 2	500 May	50	1000	Dec 3	Deposit Nat'l. Bk. of		
31	Balance		600		Junter		1000
			1000				1000
				Jan 31	Balance		600
E. & O. E. CHAS. FAIRFIELD & CO. No. 6R							

Form 33. Customer's Statement

CHAS. FAIRFIELD & CO. 927 William Street, New York, <u>Jan. 30</u> 19 <u>16</u> Mr. <u>G. Whitley</u>					
At the close of business to-day we have on our books the following OPEN TRADES for your account.					
LONG			SHORT		
Quantity	Commodity	Price	Quantity	Commodity	Price
			200	July	12.25
E. & O. E. CHAS. FAIRFIELD & CO.					
Kindly notify us at once of any discrepancy. CHAS. FAIRFIELD & CO.					

Form 34. Statement of Open Trades

No. <u>50</u>		Account - Sales of CHAS. FAIRFIELD & CO. 927 William Street, New York, <u>Jan. 2, 1916</u>			
Statement of <u>500</u> Bales Cotton <u>May 1916</u> Delivery Bought and Sold by order and for account of <u>Mr. J. Whiteley</u>					
DATE 1915	BOUGHT	POINTS	DATE 1916	SOLD	POINTS
Dec 3	200 @ 12.52	2504	Jan 2	500 @ 12.15	6075
7	100 . .	1232			
22	100 . .	1207			
29	100 . .	1192			
		6135			6075
		6075			
		60			
			Loss 60 pts \$ 300		
			CHARGES		
			COMMISSION 100		
E & O E. CRD			NET Loss \$ 400		

Form 35. Account Sales Statement

a/c Sales Number	DATE 1911	CUSTOMERS	FOL	OPTION	CUSTOMERS		CONTRACT DIFFERENCES		COMMISSION
					Dr:	Cr:	Dr:	Cr:	
50	Jan 2	S. Whitlay	✓	500 May	400			300	100
52		S. Sawyer	✓	100 July		40	60		20
53		S. H. White	✓	300 Dec.			60		60
54	11	H. Spencer	✓	2000 Jan.		5050	5450		4000
55		"	✓	1000 March	1150			950	200
56	4	W. Sauerwein	✓	700 "	40		100		140
57		J. G. Barford	✓	400 "		1080	1160		80
58	7	"	✓	200 Oct.		790	830		40
59		"	✓	800 Jan.	160				160
60	12	C. M. St. Clair	✓	900 "			180		180
61	14	W. H. Engale	✓	4500 Dec.	10425			9525	900
62		"	✓	5000 Jan.		2750	3750		1000
					12175	9710	11520	10775	2280

NOTE: The summary of the above transactions would be journalized as follows: Debits, Customers, \$2,465; Contracts, \$815; Credits, Commission, \$3,280.

Form 37. Account Sales Register or Analysis Journal

Margin up
by them \$ _____

LONG WITH" *McC Farland & Co*

JANUARY			MARCH			MAY			JULY			AUGUST			SEPTEMBER			OCTOBER			DECEMBER		
Date	Bales	Price	Date	Bales	Price	Date	Bales	Price	Date	Bales	Price	Date	Bales	Price	Date	Bales	Price	Date	Bales	Price	Date	Bales	Price
3 20	100	12.00				3 25	100	12.40										4 1	100	11.67			
"	100	12.00				"	100	12.40										"	100	"			
"	100	12.00				"	100	12.41										"	100	"			
"	100	12.00				"	100	12.42										"	100	"			
"	100	12.00				"	100	"										"	100	"			
						"	100	"										"	100	"			
						"	100	"										"	100	"			
						"	100	"										"	100	"			
						"	100	"										"	100	"			
						"	100	"										"	100	11.68			
						"	100	"										"	100	11.69			

Form 38a. Street Margin Book (left)—Long Account

MARGIN CALL	
<i>Messrs S. H. Bell & Co</i> <u>93 Exch. Place</u>	From CHAS. FAIRFIELD & CO. 927 William Street New York, <i>March 25, 1916</i>
Please deposit in <i>Empire Trust Co</i> through New York Cotton Exchange, margin to equal market price on all open contracts with you. (If deposited elsewhere, the deposit will be at your risk.) Yours respectfully, CHAS. FAIRFIELD & CO. Per pro <i>W. S. Bullen</i>	

Form 39. Margin Call

New York, <i>March 25, 1916</i> <i>Messrs Chas Fairfield & Co</i> We have this day delivered to Superintendent of New York Cotton Exchange, certified check for \$2500= for deposit in <i>N. Y. Life Ins. Trust Co.</i> in response to your call for margin.	Yours truly, S. H. BELL & CO. Per pro <i>P. D. Quincy</i>
--	---

CHECK RECEIVED
 MAR 25 1916
 WILLIAM V. KINGSLEY
Superintendent

Form 40. Margin Response

EMPIRE TRUST CO.

(Duplicate unpaid)

No 178.

New York, Feb. 2, 1916.

PAY TO THE ORDER OF

Charles Fairfield & Co. or *J. H. Hopper & Co.* as the Supt. of the New York Cotton Exchange shall direct *Two Thousand and no/100* Dollars with interest from date at the rate of 3 % per annum, to cease one year from date. This certificate is issued in conformity with the By-Laws and Rules of the New York Cotton Exchange which have been agreed to by the parties hereto and which are hereby made a condition of this deposit. In compliance with said Rules, a duplicate of like tenor and effect herewith will be issued to the said Supt. upon his demand in writing therefor, approved by the Supervisory Committee of said Exchange. Upon payment of Duplicate, this Original shall be void.

Deposit

35 days interest

Total Due

21000	21000
584	584
2100584	2100584

(Signature)

Teller

(Signature)

Secretary

PAY TO THE ORDER OF

CHAS. FAIRFIELD & CO

*J. H. Hopper & Co.**Wm. Y. Kingley*
Superintendent

Form 41a. Margin Certificate
Form 41b. Margin Certificate (back)

COTTON CONTRACT BLOTTER-Bought for <u>Jan'y 1916</u> Delivery				
Date <u>March 18, 1915</u>				
BALES	FROM WHOM	PRICE	CUSTOMER	
100	B & Co.	12 40	B & Co. - "Street let-out"	
100	"	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"

Form 42a. Street Blotter (left), showing Street let-out transactions

COTTON CONTRACT BLOTTER-Sold for <u>Jan'y 1916</u> Delivery				
Date <u>March 18, 1915</u>				
BALES	TO WHOM	PRICE	CUSTOMER	
100	D & Co.	12 40	B & Co. - "Street let-out"	
100	E & Co.	12 40	"	"
100	F & Co.	12 40	"	"
100	G & Co.	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"
100	H & Co.	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"
100	"	12 40	"	"

Form 42b. Street Blotter (right), showing Street let-out transactions

CLEARING HOUSE - NEW YORK COTTON EXCHANGE					
Report of <u>Chas Fairfield & Co.</u>			Items Cleared <u>15</u>		
New York, <u>Jan. 22, 1916.</u>			Balance Owed <u>\$2120.</u> Balance Claimed <u>.....</u>		
WE OWE TO		WE CLAIM FROM	WE OWE TO		WE CLAIM FROM
	Austin & Rand			Logan & Bryce	30
840	Backe & Co, T.S.		2100	McFarland & Co.	
	Baily & Gild		50	Muller & Co.	
	Barren & Co.				
	Bell & Co. S.H.	80		Newburg & Co.	
	Carpenter & Co.				
	Chaplin & Co, S.B.	305		O'Donnell & Co.	1310
	Clemmons & Co.				
	Dickey Bros & Co.	20		Randolf, F.C.	5
	Fairfield & Co, Chas.				
	Gibert & Co.				
1100	Gwynne & Co.			Thomas, Towne & Co.	
15	Hall & Stiles				
1500	Hamlin & Co.			Wardell & Adamson	
	Hayden, Stokes & Co.				
	Horton & Co, E.F.			Wells & Co, T.M.	250
	Hubbert Bros.		2150		1595
			RECAPITULATION		
			OWED		CLAIMED
20	Josephs & Lewis		3475	Column 1	1010
			2150	" 2	1595
	Kendal & Whitman	1505	5625		3505
	Ledman Bros		3505		
3475		1210	2120	Balance	

Form 43. Clearing House Sheet used in Settling Transactions

[illegible]

Form 45a. Brokers' Statement or Settlement Book (left)—Payment Side, corresponding to the "We Owe to" columns on Clearing House Sheet (see Form 43)

COLLECTIONS											
<u>January 22, 1916</u>											
NAME	BALES	JAN.	MAR.	MAY	JULY	AUG.	OCT.	DEC.	TOTAL		
Chaplin & Co.	2					305				305	
Dickey Bros & Co	1			20						20	
Gwynne & Co	2		210							210	
	1			200						200	
Joseph & Lewis	6							60		60	
Kendal Whitman	20			1505						1505	
Logan & Bryce	1				30					30	
O'Donnell & Co	8			1310						1310	
Peel & Co. & H.	5						80			80	
Randolph, J. C.	1				5					5	
Nella, F. M. & Co	5				250					250	
			2110	3035	285	305	80	60			
Total Collections										3975	
Bal. by check to Cl. House										2120	
										6095	

Form 45b. Brokers' Statement or Settlement Book (right)—Collection Side, corresponding to the "We Claim from" columns on the Clearing House Sheet (see Form 43)

LONG		SHORT	
	POINTS		POINTS
500 March	6375	500 July	6155
200 July	2500	500 December	6100
300 October	3676		
	12571		12255
	12255		
	\$ 316		
	6		
	\$1580		

Form 46. Customers' Open Trades

LONG		SHORT	
	POINTS		POINTS
200 March	2500	500 July	6155
300	3810	500 December	6100
200 July	2500		
300 October	3676		
	12526		12255
	12255		
	271		
	\$ 6		
	\$1355		

Form 47. Street Open Trades

CONTRACT DIFFERENCES			
DR.		CR.	
Balance from contract		From Customers' %	\$1580
Difference %	\$225		
from Street %	1355		
	\$1580		\$1580

Form 48. Contract Differences "Dummy"

(9.59 O'clock)

To Hubbert & Co

Take notice that on March 31, 1916, we shall deliver to you 50,000 pounds of cotton in about 100 square bales in accordance with the terms of our contract of sale to you. We pledge ourselves to deliver before 2 PM on the day specified for delivery, to the last holder hereof, a Warehouse receipt or receipts, or a Pro Forma bill as provided in Sec. 57 of the By-laws, and either in the same time, or as soon thereafter as practicable, an Inspector's certificate or certificates of grade, upon written notice of the last holder hereof, of the holding of the same to us, not later than 4 PM on the day previous to the one herein specified for delivery of the cotton. This notice to be delivered to us simultaneously with our delivery of the Warehouse receipt or receipts to the holder thereof.

(Signed) CHAS. FAIRFIELD & CO.
per pro W. S. Cullen

Conditions

(Conditions of sale printed here on original form)

FORM OF TRANSFER.New York, March 25 1916

TIME REC'D	ACCEPTED BY	TRANSFERRED TO
10:07	<u>Hubbert & Co</u>	<u>Carpenter Co</u>
10:22	<u>Carpenter Co</u>	<u>Springer & Co</u>
10:37	<u>Springer & Co</u>	<u>J. H. Copper & Co</u>
10:42	<u>J. H. Copper & Co</u>	<u>M. S. Farland & Co</u>

Form 49. Notice of Delivery and Form of Transfer

T. M. WELLS & CO.

New York, Mar. 29, 1916

Messrs. Chas. Fairfield & Co

We hereby inform you that we will be ready to
receive 1000 Bales of Cotton March 1916 Delivery.
as per your contract of sale dated Jan. 25, 1916.

Yours truly,

T. M. WELLS & CO.

Form 52. White & Co.'s Account in Fairfield & Co.'s Street LedgerForm 53. McFarland & Co.'s Account in White & Co.'s Street LedgerForm 54. White & Co.'s Account in McFarland & Co.'s Street Ledger

No 1738		New York, <u>December 31</u> 19 <u>15</u>	
Messrs <u>Chas. Farfield & Co.</u>			
TO M^cFARLAND & CO DR.			
TERMS CASH PAYABLE BY CERTIFIED CHECK			
MARKS A - 5522		STORES <u>Manhattan Stores</u> <u>Dock #5</u> 76 Bales <u>2 1/2</u> 16 " <u>92</u>	
92 B/c WEIGHING 49838 LBS			
May LESS ALLOWANCE 368 LBS 49470 @ 1240		\$ 6134 28	
1/2 COST INSPECTION, CLASSIFICATION & CERTIFICATES, @ 12 1/2 c/BAL		11 50	\$ 6145 78
PREMIUM FOR STAPLE X			
FOR GRADE 122-70 ^{ON} OFF MIDDLING		659 78	
STORAGE AND LABOR PAID TO <u>May 26/1915</u>		138 00	777 78
ALLOWANCE FOR UNCOMPRESSED COTTON X			
BALANCE DUE { <u>you</u> <u>US</u> }		\$	5348 00
CLASSIFICATION			
Bales	ABOVE MIDDLING	100ths	Bales BELOW MIDDLING 100ths
	FAIR @ 1 75		1 MIDDLING @ BASIS —
	STRICT MIDDLING FAIR 1.50		GOOD MIDDLING TINGED Val of Midd
	MIDDLING FAIR @ 1 30		BARELY MIDDLING @ .25
	STRICT GOOD MIDDLING @ 90	7	STRICT LOW MIDDLING @ 50 3 50
	FULLY GOOD MIDDLING @ 78	17	FULLY LOW MIDDLING @ 85 10 20
	GOOD MIDDLING @ 65	18	LOW MIDDLING @ 1.25 60.00
	BARELY GOOD MIDDLING @ 48	23	STRICT GOOD ORDINARY @ 2.00 46.00
	STRICT MIDDLING @ 32	1	GOOD ORDINARY @ 3.00 3 00
	FULLY MIDDLING @ 16		STRICT MIDDLING TINGED @ 20
	STRICT GOOD MIDDLING TINGED @ 45		MIDDLING TINGED @ 40
	MIDDLING @ BASIS		STRICT LOW MIDDLING TINGED @ 1.25
	GOOD MIDDLING TINGED Val of Midd		LOW MIDDLING TINGED @ 3.00
			MIDDLING STAINED @ 1.25
TOTAL ABOVE MIDDLING		92	TOTAL BELOW MIDDLING 122 70
E & O E <i>JR</i> • Cents and hundredths of cents per pound			

	Date
	Contract Number
	Stores
	Classification No
	Marks
	Bales
	Weight
	Stored
	Charges paid to
	Certificates expire
	Premium
	Discount
	Notice-price
	Date when samples received
	Account
	From whom received
	Contract purchase price
	Date of actual purchase
	Remarks :
	Date delivered
	To whom delivered
	Samples delivered
	Price
	Storage and labor allowed or paid
	Date of sale
	Actual sales-price
	Account
	Remarks

Form 56. Spot Register

CHAPTER XXXVII
PRODUCE BROKERAGE FORMS

BOUGHT							
CHAS. FAIRFIELD & CO.							
Corn							
New York, <u>Jan. 5</u> 19 <u>16</u>							
NAME	AMOUNT	MONTH	PRICE	SETTLING PRICE	DEBIT	CREDIT	
Hubbert Bros.	10000	May	67 ³ / ₈	67 ¹ / ₈	\$ 25 -		

Form 57. "Bought" Slip

SOLD							
CHAS. FAIRFIELD & CO.							
Wheat							
New York, <u>Jan. 21</u> 19 <u>16</u>							
NAME	AMOUNT	MONTH	PRICE	SETTLING PRICE	DEBIT	CREDIT	
Jenkins & Co.	5000	May	92 ³ / ₈	92		\$	1875

Form 58. "Sold" Slip

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